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Merger Law, Policy, and Enforcement Guidelines in Canada

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Abstract. The paper describes Canada's merger law, policy, and enforcement activity. The contents of Canada's recently issued *Merger Enforcement Guidelines* are explained, analyzed, and compared to the U.S. Merger Guidelines. The roles of concentration, market share, entry conditions, and efficiency defenses in Canadian merger cases are assessed. Reference is made to some recent decisions of Canada's Competition Tribunal, a body created as a part of the major competition policy reforms contained in the 1986 Competition Act.

Key words. Canada, enforement guidelines.

I. Background

Until 1986, Canada did not have a merger law worthy of the name. True, mergers were explicitly included in the Combines Act of 1910 and in every amended version thereafter. However, the criminal nature of the law required proof 'beyond reasonable doubt' that the merger was 'detrimental' to the public. Worse, convoluted court interpretations prevented the Crown from presuming 'public detriment' solely on the basis of evidence that the merger would' substantially lessen competition'. The result was a totally ineffective merger law. Thus, prior to 1986, the Canadian government never won a contested merger case. The only 'victory' for the Crown occurred in 1970, when a tariff-protected domestic monopolist, the Electric Reduction Company (ERCO), charged primarily with monopolistic behavior and prepared to submit to an extensive prohibition order governing its discriminatory pricing, pled guilty to a charge of merger. But ERCO pled guilty only after assurance that it would not have to divest itself of the newly-announced competitor it had just acquired (RTPC, 1966; McFetridge, 1974).

In 1986, after almost two decades of reform effort, the Parliament of Canada replaced the Combines Investigation Act of 1960 with a new Competition Act. The Competition Act comprises 128 sections, no fewer than 25 of which deal with mergers, including the provisions for pre-notification of large acquisitions. Mergers are now dealt with under the civil law provisions of the Act and are reviewable by a newly-created, quasi-judicial board (it includes both lay persons and federal court judges) called the Competition Tribunal. The new merger law follows section

7 of the U.S. Clayton Act in establishing that justiciable harm occurs when a merger 'prevents or lessens, or is likely to prevent or lessen competition substantially' (s.92(1)). Unlike the Clayton Act, the Competition Act provides an' efficiency defense' (s.96(2)) which acts as an override if the gains in efficiency are 'greater than the effects of any prevention or lessening of competition'. The Competition Act also contains a non-exclusive list of factors (s.93), such as foreign competition; barriers to entry; extent of remaining competition; elimination of a 'vigorous and effective competitor'; innovation; availability of substitutes; failing firm; to be considered in assessing whether competition has been lessened substantially by the merger. Finally, a novel feature of the Act are the provisions (s.99) that would allow an otherwise harmful merger to stand if the reduction or removal of tariff or non-tariff barriers reestablishes adequate competition.

Since the Competition Act's implementation in June 1986, the Bureau of Competition Policy's merger branch has been active.[1] Table I shows the number of domestic and foreign mergers in Canada in the last thirty years. There is no obvious impact of the new Act on the total *number* of mergers, although there is a curious decline in domestic mergers in 1990, perhaps recession-related. Table II shows the number of merger examinations commenced and concluded in each year and how they were dealt with. Of particular interest are (i) the 12 mergers in which examination by the merger branch led to restructuring; (ii) the 10 mergers that were abandoned as a result of examination; and (iii) the 10 mergers in which the Bureau sought some form of relief by applying to the Competition Tribunal.

Table II shows that the heavy activity of the Bureau's merger branch is not the result of 'fishing expeditions' – although these may occur from time to time. Between 40 and 50% of the examinations were undertaken in response to mergers that were large enough to require notification under the Act. Thirty to forty percent of the cases were in response to firms requesting an 'advance ruling certificate', confirming that the Bureau has no objection to a proposed merger, as provided for under section 102 of the Competition Act.

II. The Guidelines Compared

In March 1991, the Bureau of Competition Policy issued *Merger Enforcement Guidelines* (afterward 'Guidelines'). As in the case of the U.S. Merger Guidelines, the Guidelines were issued not only as a means of providing business with a better understanding of the approach taken by the Bureau's Merger Branch in carrying out its enforcement responsibilities, but as a means of providing a 'single unifying framework for evaluating the likely impact of mergers on competition in Canada'. (Guidelines, 1991, Preface).

The Canadian and U.S. merger guidelines contain both similarities and differences. Despite a common criterion for merger harm, i.e., that the merger substantially lessens competition, the Canadian merger guidelines are constrained by the Canadian merger law in at least one important way that the U.S. guidelines are

Table I. Mergers in Canada 1960–1990[a]

Year	Foreign[b]	Domestic[c]	Total
1960	93	110	203
1961	86	152	238
1962	79	106	185
1963	41	88	129
1964	80	124	204
1965	78	157	235
1966	80	123	203
1967	85	143	228
1968	163	239	402
1969	168	336	504
1970	162	265	427
1971	143	245	388
1972	127	302	429
1973	100	252	352
1974	78	218	296
1975	109	155	264
1976	124	189	313
1977	192	203	395
1978	271	178	449
1979	307	204	511
1980	234	180	414
1981	200	291	491
1982	371	205	576
1983	395	233	628
1984	410	231	641
1985	466	246	712
1986	641	297	938
1987	622	460	1082
1988	593	460	1053
1989	691	400	1091
1990	676	268	944

Source: Director of Investigation and Research, Competition Act, *Annual Reports*, Minister of Supply and Services Canada, 1989, p. 47; 1991, p. 5.

[a] Merger information is collected in the Bureau of Competition Policy's merger register.

[b] Acquistions involving a foreign-owned or foreign-controlled *acquiring company*.

[c] Acquisitions involving an *acquiring* company not known to be foreign-owned or foreign-controlled.

not constrained by the usual court and Justice Department interpretations given to the U.S. merger law. This difference is most clearly illustrated by the framework of the U.S. merger guidelines which are built around concentration or market share thresholds, summed up in the HHI index (Salop, et al., 1987). While the U.S. Merger Guidelines give weight to entry and efficiency conditions, as well as to whether the acquired firm would otherwise have failed, there is no legal impediment to blocking a merger on concentration or market share grounds alone. Thus if the market is sufficiently concentrated (greater than 1800 HHI points) and the change in concentration due to the merger is substantial (greater than 100 HHI points) the Guidelines indicate the Justice Department may proceed against the

Table II. Merger examinations in Canada under Competition Act, 1986–91

	1986–87[a]	1987–88	1988–89	1989–90	1990–91
Examinations commenced (2 or more days of review)	40	146	191	219	193
Arising from notifiable transactions	n/a	65	92	109	75
Arising from advanced ruling certificate requests	n/a	40	70	87	87
Total examinations concluded[b]	26	133	182	223	183
As posing no issue under the Act	17	120	166	204	170
With monitoring only	5	7	10	13	10
With restructuring	1	4	4	1	2
With consent orders	–	–	–	3	–
Parties abandoned proposed merger in whole or in part	3	2	2	2	1
Examinations ongoing at end of year	14	25	32	31	39
Applications before Tribunal					
Concluded or withdrawn	1	–	2	3	–
Ongoing	–	2	2	1	3

Source: Director of Investigation and Research, Competition Act, *Annual Report*, Year ending March 31, 1991, Minister of Supply and Services Canada, 1991, p. 6.
[a] Statistics commenced as of June 19, 1986. Remaining years reflect period April 1–March 31.
[b] Excludes ongoing matters before the tribunal.

merger. Historically, the U.S. courts have shown a willingness to find against mergers on concentration grounds alone. Not so in Canadian law. Section 92(2) of the Competition Act expressly prohibits a finding of merger harm – i.e., a substantial lessening of competition – solely on the basis of concentration or market share. Section 92(2) reads:

> For the purpose of this section the Tribunal shall not find that a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially solely on the basis of evidence of concentration or market share.

As a result of s.92(2), the Bureau of Competition Policy is deterred from suggesting any thresholds beyond which a merger will be presumed to substantially lessen competition. The Guidelines (1991, p.21) do say, however, that high market share or concentration is a 'necessary condition that must exist' before there is a finding that a merger is likely to substantially lessen competition. But they are not sufficient conditions. One or more 'competitive factors', such as those found in s.93, for example, high barriers to entry, lack of foreign competition, or elimination of an effective competitor, must also be present and must convincingly suggest that, in combination with the market shares involved, there is likely to be a substantial lessening of competition.

However, the Guidelines do indicate market share-concentration conditions under which a merger generally will *not* be challenged, 'safe harbours' so-to-speak. Two situations are distinguished, reflecting the distinction between (i) 'merger for monopoly' or dominant firm status, such that the merging parties will be able to *unilaterally* exercise greater market power than in the absence of mergers, and (ii) the 'collusion theory of mergers', such that a merger increases the likelihood of an *interdependent* exercise of power among leading firms in the market. In the former, unilateral, case, challenges will *not* be made where the post-merger market share of the merged entity is less than 35%. In the latter, interdependent, case, challenges will *not* be made where the post-merger share of the market accounted for by the four largest firms in the market is less than 65% and the post-merger market share of the merged firm is less than 10%.

Despite differences in their approach to thresholds, the imprint of the U.S. Merger Guidelines (1982 and 1984) is clearly evident in the Canadian Guidelines. This is no more clearly indicated than in the conceptual framework that is employed by each to define the relevant market, product and geographic. According to the Guidelines (1991, p. 7)

> Conceptually, a relevant market for merger analysis under the Act is defined in terms of the smallest group of products and smallest geographic area in relation to which sellers, if acting as a single firm (a 'hypothetical monopolist') that was the only seller of these products in that area, could (profitably) impose and sustain a significant and nontransitory price increase above levels that would likely exist in the absence of the merger.

This is essentially the thought experiment that first appeared in the 1982 U.S. Merger Guidelines, and in each revision since. Even the wording and implied magnitudes are similar. For example, where the Canadian Guidelines refer to the ability to 'sustain a significant and nontransitory price increase' the U.S. Guidelines (1992, p. 55) refer to a 'small but significant and nontransitory price increase'. In each case 'significant' is 5% 'in most contexts'. 'Nontransitory' is interpreted as one year or more in the Canadian Guidelines and as 'lasting for the forseeable future' in the U.S. Guidelines.

There are other similarities between the two sets of Guidelines. Naturally, good economic analysis would give an important role to entry conditions – as both sets of Guidelines do. It was not inevitable, however, that both sets of Guidelines would define 'timely entry' as that occurring within *two* years on a sufficient scale to deter or counteract the competitive effects of concern. Moreover, both sets of Guidelines deservedly give substantial weight to the role of sunk costs in determining whether committed entry is likely, or would be timely. In line with economic analysis, abundant evidence of very 'easy entry' conditions is virtually sufficient for a finding that a merger is *not* likely to enhance market power and lessen competition.

III. Analysis

The strong similarities (the threshold exception notwithstanding) between the Canadian and U.S. Guidelines should not obscure some subtle differences in emphasis – ones that are in good part attributable to differences in the respective market structures and the relative influences of international trade. Canada's small and, until recently, highly protected domestic markets stand in some contrast to those in the U.S., which are, on average, an order of magnitude larger, are structurally more competitive, and, until recently, less protected. Although the globalization of markets, the Canada-U.S. Free Trade Agreement, and the general lowering of trade barriers through successive GATT negotiations now mean that most Canadian markets are no longer insulated from the strong winds of international competition, Canada's typically concentrated market structures are only slowly responding to the changing external forces. And as they respond, many Canadian markets are likely to become more rather than less concentrated (if one calculates on the basis of domestic production alone) as trade-induced competitive pressures lead to greater plant scale and specialization, longer production runs and fewer (domestically) competing firms. Thus the forces of greater competition, blowing mainly from abroad, will inevitably make many domestic markets look more concentrated, although on a more relevant extra-national (e.g., North American) basis they may appear more structurally as well as behaviourally competitive.

The market structural differences between the U.S. and Canada are reflected in their respective merger laws, Guidelines, and enforcement. These differences show up in at least two important ways. First, Canada's merger law includes an explicit efficiency defense or 'exception', (s.96), while the U.S. law (Clayton s.7) does not. This difference is reflected in the two sets of Guidelines. The Canadian Merger Guidelines outline the manner in which the Bureau will assess respondent claims that merger created efficiencies exceed the effects of merger enhanced market power – a favorable (to the firms) finding for which would exempt the acquisition from orders otherwise made under the merger law. In contrast, the U.S. Merger Guidelines would 'consider' efficiency claims, but the language is couched in doubt that many challenged mergers would interfere with the achievement of available efficiencies.

Second, the type of merger harm envisioned by the two sets of Guidelines differ. The U.S. Merger Guidelines are in good part founded on a 'collusion theory of mergers' – i.e., that the most likely harm produced by a horizontal merger is that it will enhance oligopolistic *interdependence* to the point that it makes collusion more likely and cheating (on agreements) easier to detect. In contrast, the Canadian Merger Guidelines, and enforcement, to date, of the merger law, emphasize the impact that a merger may have in creating a dominant firm with the ability to exercise *unilateral* market power.[2] I shall briefly expand on each of these differences.

A. EFFICIENCY DEFENSE

Ever since Williamson's (1968) classic paper, it has been clear that if efficiency, rather than competition as such, is the goal of the antitrust laws (a suggestion which only economists would consider indisputable), then one cannot ignore the possibility that a merger may enhance efficiency by producing scale efficiency rectangles that equal or exceed market power loss triangles. This possibility becomes something closer to a probability in small domestic markets such as Canada's, where smaller than efficient scale plants, whose product-packed output is characterized by short production runs, are rationalizing under the pressure of tariff reduction and greater two way trade opportunities.[3] That mergers may enhance efficiency sufficiently to warrant exempting them from the market power creating prohibitions in s.92 is indicated in s.96 which reads:

> The tribunal shall not make an order under section 92 if it finds that the merger or proposed merger – has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger and that the gains in efficiency would not likely be attained if the order were made.

What s.96 does is resolve conflicts between competition and efficiency goals in favor of efficiency, assuming, of course, that the efficiency gains are great enough. But note that the s.96 defense applies only if the efficiencies could not reasonably have been attained otherwise, such as through internal expansion. The U.S. Merger Guidelines take a similar position. Note, as well, the curious reference to efficiency gains that are both 'greater than' *and* 'will offset.' The Guidelines (pp. 48–49) interpret these terms as follows: where efficiency gains and anticompetitive effects can be 'weighed in similar terms' the former must be 'great than' the latter; *and* where they cannot be weighed in similar terms the gains must 'offset' (i.e., 'neutralize') the anticompetitive effects, for the efficiency exception to apply in a particular case. Given the potential ambiguities and disputes to which this cumbersome wording and its bureaucratic interpretation could give rise, it is fortunate that, to date, the efficiency exception has not appeared to play a central role in any merger case taken before the Tribunal.[4]

B. UNILATERAL VS. INTERDEPENDENT EXERCISE OF MARKET POWER

In the Preface to the *Merger Enforcement Guidelines* (1991, p. i) the Bureau acknowledges that 'to date, most of the mergers that the Director has concluded would likely have prevented or lessened competition substantially have raised concerns about the ability of merging partners to unilaterally exercise market power'. The emphasis on the unilateral, as opposed to interdependent, exercise of market power is both predictable and appropriate given the impact that Canada's peculiar demography-geography has on its domestic market structures. It is evident in the major merger cases on which the Competition Tribunal (CT) has rendered decisions.[5]

In *DIR and Gemini (1989)* (CT 89/1) the Bureau moved against the unrestricted merger of Canada's only two airline computer reservation systems (CRSs). Instead of blocking the merger, however, a consent decree was agreed to, and accepted by the Competition Tribunal, substantially restraining the post-merger behaviour of the CRS. In *DIR and Imperial Oil Ltd. (1989)* (CT 89/3) the Bureau moved to restructure the acquisition of Texaco Canada's assets by Exxon Corporation's Canadian subsidiary, Imperial Oil. In particular, Imperial Oil was forced to sell the Texaco Canada assets located in the Maritime provinces, including the regionally important Eastern Passage refinery. The sale was made to Ultramar Canada Inc., thereby assuring that Imperial would have at least two important competitors in the region. In *DIR and Asea Brown Boveri Inc.*et al. *(1989)* (CT/89/1), the Bureau secured Tribunal approval of a consent decree in which Asea Brown Boveri was allowed to purchase assets of Westinghouse Canada, its only competitor in the very large electrical transformer business, on condition that tariff duties on foreign imports be remitted or eliminated. The option of securing a reduction, removal, or remission on duties rather than dissolving or preventing a merger which would otherwise prevent or lessen competition substantially is provided for under s.99 of the Competition Act. Finally, in *DIR and Hillsdown Holdings (Canada) Inc. (1992)* (CT 91/1), the first fully contested merger case (no consent decree involved) on which a Tribunal decision has been rendered the Competition Tribunal refused, in a 'borderline' decision, to order Hillsdown to divest itself of a red meat rendering business over which it had gained control when Hillsdown had acquired Canada Packers Inc. in 1990. Hillsdown already controlled a rendering operation through its ownership of Maple Leaf Mills. While the Competition Tribunal agreed that the merger would lessen competition, it refused to accept the Bureau's argument that Hillsdown's control of both rendering firms would lessen competition 'substantially' in the relevant geographic market, Ontario. The Competition Tribunal rested its decision on the declining nature of the red meat rendering market and the existence of potential competitors in adjacent product and geographic markets.

The Competition Tribunal's *Hillsdown Holdings* decision has at least two interesting facets. First, the Competition Tribunal's belief that there is substantial potential competition led them to place little weight on the Bureau's claim that the merged firm would behave as a 'dominant firm'. Second, the Competition Tribunal rejected Hillsdown's efficiency (s.96) claims, concluding that the claims were either not convincing or that the savings did not arise as a result of the merger. The Tribunal recognized, of course, that its decision on efficiency claims were moot, given its decision that the merger would *not* substantially lessen competition.

However, the Tribunal did have something to say on the efficiencies issue that could be important in future cases. The Tribunal found it difficult to accept respondent's interpretation of the efficiency defense (s.96(1)), that merger harm is limited to whatever allocative inefficiency or deadweight loss it produces. The Competition Tribunal rejected the deadweight loss limitation on the measure of merger harm, in spite of the fact that the Bureau's own *Merger Enforcement Guidelines* (p. 49) take the same position as that of the respondents in the *Hillsdown* case. In viewing the issue of potential merger harm more broadly than simply its deadweight loss, the Tribunal made reference to section 1.1 of the Competition Act, which is worth stating in full:

(1.1) The *purpose* of this Act is to maintain and encourage competition in Canada in order *to promote the efficiency and adaptability of the Canadian economy*, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to assure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and *in order to provide consumers with competitive prices* and product choices. (emphasis added)

The Tribunal's reading of the 'purpose' of the Competition Act is that it is aimed at more than narrow efficiency concerns. The second italicized clause above suggests that some of what economists treat as merely a redistribution of income may be considered by the Competition Tribunal as a part of a market power creating merger's harm – to be weighed, in any efficiency defence, against any convincing cost savings. The Tribunal's interpretation – which at face value appears consistent with the wording of the Act – harkens back to a debate that received considerable attention in U.S. law journals almost a decade ago (see especially Fisher and Lande, 1983).

IV. Conclusion

The Competition Act of 1986 changed Canada's merger law in almost every respect imaginable. Canada's merger law went from the least used, least operative, and least enforceable part of the pre-1986 Combines Investigation Act, to arguably the part of the new Competition Act which now uses the most Bureau resources and occupies the most Bureau time (other than the misleading advertising sections). Ironically, the changes in the law came at a time when economists were increasingly skeptical about the economic case for antitrust policy and the 'mainline' industrial organization paradigm, that provides the chief analytical foundation and framework for competition policy (Green, 1987).[6] Nevertheless, Canadian enforcement of the merger provisions of the Act has survived the more extreme versions of industrial organization 'revisionism', which now appear in retreat. Still, in 1987, I concluded a paper on the economic case for competition policy by arguing that a *de minimus* program, consistent with both the efficiency considerations vital to a restructuring Canadian economy and the widely agreed upon principles and evidence that provide the foundation for the field of industrial organization, called only for restraints on the creation of mergers that produce 'monopoly' (a dominant firm), essentially the approach, to date, of those who enforce Canada's competition laws.[7]

A final observation. Both the U.S. and Canadian merger guidelines give short shrift to conglomerate mergers. The lack of attention paid to conglomerate mergers is probably inevitable given the orientation of both the U.S. and Canadian laws toward the impact of mergers on competition in particular markets. Nevertheless, if one takes seriously the suggestions in both the Competition Act (s.1.1) and the merger guidelines that competition is essentially a means of achieving the ultimate objective of greater efficiency, it is not so clear why conglomerate mergers have not come in for greater scrutiny. The conglomerate merger route to firm growth and diversification, all the rage in the 1970s and 1980s, is now in retreat due largely to efficiency failures in the management of large, multi-industry enterprises. Moreover, the 1980s route to conglomeration, the leveraged buyout and its country cousin the junk bond, have saddled American corporations with large amounts of costly private debt to complement the huge amounts of government debt. It is an interesting, even if unanswerable, question as to where the social costs of mergers have been greatest: in the horizontal mergers among firms in increasingly globalized markets or in the easy means to conglomerate growth made possible by a combination of financial innovation and the lack of a coherent economic argument why there should be legal restraints on conglomerate acquisition.

Notes

[1] The Bureau of Competition Policy administers the Competition Act.

[2] This is not to say that the U.S. Guidelines ignore unilateral exercises of market power or that the Canadian Guidelines ignore enhanced interdependence (they do not), but only where the relative emphases lie.

[3] It is perhaps ironic that as the pressures for industrial rationalization have increased in Canada, new 'flexible manufacturing' technology, led by CAD/CAM is making short production runs economical, especially in the face of increasingly specialized demands and customer-oriented design. See Milgrom and Roberts (1990).

[4] Admittedly, this statement may mean little given the relatively small number of Tribunal-adjudicated merger cases, to date, and the fact that several of them came in the forms of Consent Decrees that the Bureau wanted the Tribunal to 'ratify'.

[5] It should be noted that in some cases the decisions revolved around Tribunal acceptance (or nonacceptance) of consent decrees reached between the mergers partners and the Bureau – decrees which would restructure the merger in certain geographic or product respects.

[6] This was a time when the Chicago-UCLA (Demsetz, 1973; Peltzman, 1976) behaviour-mutually-determines-structure-and-performance and the contestable markets paradigms (both of which were largely hostile to competition policy) were in full swing, as were stock market 'event studies' which purported to show that most mergers were relatively efficient (see especially Eckbo, 1983, 1986). Fortunately, the wilder claims of the contestability paradigm were rather quickly spiked (Shepherd, 1984).

[7] I hasten to say that I do not suggest for a moment that official policy was in any way influenced by my own views.

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