Competition Bureau Canada
Bureau de la concurrence Canada

Enforcement Guidelines

Merger Enforcement Guidelines

Canada

This publication is not a legal document. It contains general information and is provided for convenience and guidance in applying the *Competition Act*.

This publication replaces the following Competition Bureau publications:
Enforcement Guidelines — *Merger Enforcement Guidelines*, September 01, 2004
Bulletin — *Efficiencies in Merger Review*, March 2, 2009

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Cat. No. Iu54-41/2011E-PDF
ISBN 978-100-17992-6

2011-10-06

Aussi offert en français sous le titre Fusions – Lignes directrices pour l'application de la loi.

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FOREWORD

The Competition Bureau ("the Bureau") has issued these guidelines to provide general direction on its analytical approach to merger review. The guidelines describe, to the extent possible, how the Bureau analyzes merger transactions. Given that merger law applies to a wide variety of factual circumstances, these guidelines are not applied rigidly. As such, this document sets out the Bureau's general approach to merger review and is not a binding statement of how the analysis is carried out in any particular case. The specific facts of a case, as well as the nature of the information and data available, determine how the Bureau assesses a proposed transaction and may sometimes require methodologies other than those noted here.

Merging parties are encouraged to contact the Bureau at an early stage to discuss proposed transactions, and should obtain appropriate legal advice when contemplating a merger.[1] The final interpretation of the *Competition Act* (the "Act") rests with the Competition Tribunal ("the Tribunal") and the courts.[2]

These guidelines supersede previous merger enforcement guidelines and statements made by the Commissioner of Competition ("the Commissioner") or other Bureau officials. These guidelines also supersede the Bureau's *Bulletin on Efficiencies in Merger Review*. The Bureau may revisit certain aspects of these guidelines in the future based on amendments to the Act, decisions of the Tribunal and the courts, developments in the economic literature and the Bureau's case experience.

PART 1: DEFINITION OF MERGER

1.1 Section 91 of the Act defines a "merger" as "...the acquisition or establishment, direct or indirect, by one or more persons, whether by purchase or lease of shares or assets, by amalgamation or by combination or otherwise, of control over or significant interest in the whole or a part of a business of a competitor, supplier, buyer or other person."

1.21 This definition covers any manner in which control over, or a significant interest in, the whole or a part of a business of another person is acquired or established.[3] While these guidelines focus primarily on mergers of firms that supply competing products (horizontal mergers), section 91 also captures mergers of firms that do not compete (non-horizontal mergers, addressed in Part 11, below).

1 See also the Bureau's *Merger Review Process Guidelines*, *Procedures Guide for Notifiable Transactions and Advance Ruling Certificates under the* Competition Act and *Fee and Service Standards Handbook for Mergers and Merger-Related Matters*.

2 *Competition Act*, R.S.C. 1985, c. C-34.

3 As outlined in the Bureau's Competitor Collaboration Guidelines, paragraph 1.2(*a*), a transaction that does not fall within the definition of "merger" may in some instances be subject to review under the civil provision in section 90.1 of the Act. Parties who are uncertain as to whether an agreement will be assessed as a merger or a competitor collaboration are encouraged to consult the *Competitor Collaboration Guidelines* and to contact the Bureau at the earliest opportunity to discuss how the Bureau is likely to assess such an agreement if pursued.

Control

1.3 Acquisition of control constitutes a merger under section 91. With respect to corporations, section 2(4) of the Act defines "control" to mean *de jure* (legal) control—that is, a direct or indirect holding of more than 50 percent of the votes that may be cast to elect directors of the corporation, and which are sufficient to elect a majority of such directors. With respect to partnerships, section 2(4) provides that a partnership is controlled by a person when the person holds an interest in the partnership that entitles the person to receive more than 50 percent of the profits of the partnership or more than 50 percent of its assets on dissolution.

Significant Interest

1.4 The Act does not define what constitutes a "significant interest," as referenced in section 91, leaving this concept to be construed within the broader context of the Act as a whole.

1.5 When determining whether an interest is significant, the Bureau considers both the quantitative nature and qualitative impact of the acquisition or establishment of the interest. Given that the Act is concerned with firms' competitive market behaviour, a "significant interest" in the whole or a part of a business is held qualitatively when the person acquiring or establishing the interest (the "acquirer") obtains the ability to materially influence the economic behaviour of the target business, including but not limited to decisions relating to pricing, purchasing, distribution, marketing, investment, financing and the licensing of intellectual property rights.

1.6 The factors that may be relevant to the Bureau's analysis of whether a particular minority shareholding, an interest in a combination, agreement or other relationship or interest confers material influence (as per paragraph 1.5) include the following:

- voting rights attached to the acquirer's shareholdings or interest in a combination;
- the status of the acquirer of partnership interests (e.g., general or limited partner) and the nature of the rights and powers attached to the partnership interest;
- the holders and distribution of the remaining shares or interests (whether the target business is widely or closely held, and whether the acquirer will be the largest shareholder);
- board composition[4] and board meeting quorum, attendance and historical voting patterns (whether the acquirer will be able to carry or block votes in a typical meeting);
- the existence of any special voting or veto rights attached to the acquirer's shares or interests (e.g., the extent of shareholder approval rights for non-ordinary-course transactions);
- the terms of any shareholder or voting agreements;

4 This includes both the total number of directors and the number of directors who are the acquirer's nominees.

- the dividend or profit share of the minority interest as compared to the acquirer's equity ownership share;
- the extent, if any, of the acquirer's influence over the selection of management or of members of key board committees;
- the status and expertise of the acquirer relative to that of other shareholders;
- the services (management, advisory or other) the acquirer is providing to the business, if any;
- the put, call or other liquidity rights, if any, that the acquirer has and may use to influence other shareholders or management;
- the access the acquirer has, if any, to confidential information about the business; and
- the practical extent to which the acquirer can otherwise impose pressure on the business's decision-making processes.

It is generally the combination of factors – not the presence or absence of a single factor – that is determinative in the Bureau's assessment of material influence.

Notifiable Transactions

1.7 In the absence of any evidence to the contrary, the Bureau presumes that notifiable transactions described in Part IX of the Act constitute the acquisition or establishment of a significant interest in the whole or a part of a business. A transaction is notifiable where the relevant transaction-size and party-size thresholds are exceeded and, in the case of a share acquisition[5], where the shareholding threshold (voting interest of more than 35% for a private corporation or more than 20% for a public corporation) is also exceeded.

Share Acquisitions

1.8 Share acquisitions (whether or not they are notifiable) fall within the scope of section 91 when the acquirer obtains the ability to materially influence the economic behaviour of a business by purchasing shares or other securities. When assessing whether a particular minority shareholding confers material influence, the Bureau conducts a case-by-case analysis of the relationship between the acquirer and the target business, and of the various mechanisms through which the acquirer might exercise influence.

1.9 In the case of *voting shares*, the Bureau considers that a significant interest in a corporation exists when one or more persons directly or indirectly hold enough voting shares

5 Where the transaction involves the acquisition of an interest in a combination, a further threshold also applies. Such a transaction will be notifiable only if the person or persons acquiring the interest, together with their affiliates, would be entitled to receive more than 35% of the profits of the combination (more than 50% if they are already entitled to more than 35%), or 35% of its assets on dissolution (more than 50% if they are already entitled to more than 35%).

- to obtain a sufficient level of representation on the board of directors to materially influence that board, with reference to the factors outlined in paragraph 1.6 and any other relevant factors; or
- to block special or ordinary resolutions of the corporation.

1.10 The Bureau will also consider whether voting shares give the person or persons who hold them the ability to exercise material influence through other mechanisms, with reference to the factors outlined in paragraph 1.6 and any other relevant factors. In the absence of other relationships, direct or indirect ownership of less than 10 percent of the voting interests in a business does not generally constitute ownership of a significant interest.[6] While inferences about situations that result in a direct or indirect holding of between 10 percent and 50 percent of voting interests are more difficult to draw, a larger voting interest is ordinarily required to materially influence a private company than a widely held public company. The merger notification requirements in Part IX of the Act, referred to in paragraph 1.7 above, are triggered at a voting interest of more than 35 percent for private corporations and of more than 20 percent for public corporations.[7]

1.11 When a transaction involves the purchase of *non-voting* shares,[8] the Bureau examines whether the holder of the minority interest can materially influence the economic behaviour of the business despite its inability to vote its shares, with reference to the factors outlined in paragraph 1.6 and any other relevant factors.

1.12 In the case of *convertible securities* or *options*, a significant interest may be acquired or established when these securities are first purchased or created, or at the time they are converted or exercised.[9] To determine whether a purchase constitutes a significant interest, the Bureau examines the nature of and circumstances in which the rights (or potential rights) attached to these securities may be exercised, and the influence that the acquirer may possess through their exercise, or threat of exercise, with reference to the factors outlined in paragraph 1.6 and any other relevant factors.

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6 This position is consistent with other Canadian statutes. See, for example, *Bank Act*, S.C. 1991, c. 46, s. 8. (See also *Cooperative Credit Associations Act*, S.C. 1991, c. 48, s. 9; *Insurance Companies Act*, S.C. 1991, c. 47, s. 8; and *Trust and Loan Companies Act*, S.C. 1991, c. 45, s. 8.) The Bureau typically requires disclosure of all holdings that account for 10 percent or more of the voting interests in a business, and may seek information respecting other minority holdings in the course of a merger review.

7 The pre-merger notification provisions are discussed in the Bureau's *Procedures Guide for Notifiable Transactions and Advance Ruling Certificates under the* Competition Act and the *Interpretation Guidelines for Notifiable Transactions under Part IX of the* Competition Act.

8 When *non-voting* shares are convertible (for example, into voting shares), they will also be assessed under paragraph 1.12.

9 A convertible security is a bond, debenture, preferred share or other security that may be exchanged by the owner, usually for common shares of the same company, in accordance with specified conversion terms. An option is a right to buy or sell specific securities or properties at a specified price within a specified time.

Asset Acquisitions

1.13 Asset transactions (whether or not they are notifiable) that generally fall within the scope of section 91 include the purchase or lease of an unincorporated division, plant, distribution facilities, retail outlet, brand name or intellectual property rights from the target company. The Bureau treats the acquisition of any of these essential assets, in whole or in part, as the acquisition or establishment of a significant interest in that business. Further, acquiring a subset of the assets of a business that is capable of being used to carry on a separate business is also considered to be the acquisition or establishment of a significant interest in the business.

Increasing an Existing Interest in a Business

1.14 Persons already holding a significant interest in the whole or a part of a business may trigger the merger provisions of the Act by acquiring or establishing a materially greater ability to influence the economic behaviour of the business.

Interlocking Directorates

1.15 An interlocking directorate may arise where a director of one firm is an employee, executive, partner, owner or member of the board of directors of a second firm, or has another interest in the business of the second firm. An interlocking directorate is generally of interest under section 92 of the Act only when the interlocked firms are competitors, are vertically related, or produce complementary or related products.

1.16 Interlocking directorates may be features of transactions that otherwise qualify as mergers. For example, an interlock results from the merger of firms A and B when an executive of A sits on the board of firm C, and C competes with B. Interlocking directorates may be features of minority interest transactions; for example, a firm that acquires a minority interest in its competitor may also obtain rights to nominate one or more directors to its competitor's board. An interlocking directorate would rarely qualify, in and of itself, as the establishment of a significant interest.

1.17 When assessing whether an interlocked director has the ability to materially influence the economic behaviour of the interlocked firm(s), the Bureau's focus is typically on the access that an interlocked director has to confidential information, and on the director's voting and veto rights in the context of the board composition, quorum and voting rules, including attendance and historical voting patterns.

Other Considerations

1.18 A significant interest can be acquired or established under shareholder agreements, management contracts, franchise agreements and other contractual arrangements involving corporations, partnerships, joint ventures, combinations and other entities, depending on the terms of the arrangements. In addition, loan, supply and distribution arrangements that are not ordinary-course transactions and that confer the ability to materially influence the economic behaviour of the target business (for example, financing arrangements and terms of default relating to such arrangements; long-term contractual arrangements or pre-existing long-term business relationships) may constitute a merger within the meaning of section 91.

1.19 When determining whether an acquisition or establishment of a significant interest constitutes a merger, the Bureau examines the relationship between the parties prior to the transaction or event establishing the interest, the likely subsequent relationship between the parties, the access that an acquirer has and obtains to confidential business information of the target business, and evidence of the acquirer's intentions to affect the behaviour of that business.

PART 2: THE ANTI-COMPETITIVE THRESHOLD

Overview

2.1 As set out in section 92(1) of the Act, the Tribunal may make an order when it finds that a merger "prevents or lessens, or is likely to prevent or lessen, competition substantially." A substantial prevention or lessening of competition results only from mergers that are likely to create, maintain or enhance the ability of the merged entity, unilaterally or in coordination with other firms, to exercise market power.

2.2 In general, when evaluating the competitive effects of a merger, the Bureau's primary concerns are price and output. The Bureau also assesses the effects of the merger on other dimensions of competition, such as quality, product choice, service, innovation and advertising—especially in markets in which there is significant non-price competition. To simplify the discussion, unless otherwise indicated, the term "price" in these guidelines refers to all aspects of firms' actions that affect the interests of buyers. References to an increase in price encompass an increase in the nominal price, but may also refer to a reduction in quality, product choice, service, innovation or other dimensions of competition that buyers value.

2.3 These guidelines describe the analytical framework for assessing market power from the perspective of a seller of a product or service ("product," as defined in section 2(1) of the Act). Market power of sellers is the ability of a firm or group of firms to profitably maintain prices above the competitive level for a significant period of time. The jurisprudence establishes that it is the *ability* to raise prices, not whether a price increase is likely, that is determinative.

2.4 The Bureau also applies this analytical framework to its assessment of the market power of the buyers of a product. Market power of buyers is the ability of a single firm (monopsony power) or a group of firms (oligopsony power)[10] to profitably depress prices paid to sellers (by reducing the purchase of inputs, for example) to a level that is below the competitive price for a significant period of time. Part 9, below, sets out the Bureau's approach to situations of monopsony power.

10 Oligopsony power occurs where market power in the relevant purchasing market is exercised by a coordinated group of buyers. Except where otherwise indicated in these guidelines, the term "monopsony" includes situations of oligopsony.

2.5 The Bureau analyzes competitive effects under two broad headings: unilateral exercise of market power and coordinated exercise of market power. The same merger may involve both a unilateral and a coordinated exercise of market power.

2.6 A unilateral exercise of market power can occur when a merger enables the merged firm to profitably sustain higher prices than those that would exist in the absence of the merger, without relying on competitors' accommodating responses.

2.7 A coordinated exercise of market power can occur when a merger reduces the competitive vigour in a market by, for example, removing a particularly aggressive competitor or otherwise enabling or enhancing the ability of the merged firm to coordinate its behaviour with that of its competitors. In these situations, higher post-merger prices are profitable and sustainable because other competitors in the market have accommodating responses.

2.8 When a merger is not likely to have market power effects, it is generally not possible to demonstrate that the transaction will likely prevent or lessen competition substantially, even though the merger might have implications for other industrial policy objectives that are beyond the scope of the Act.

Lessening of Competition

2.9 A merger may substantially lessen competition when it enables the merged firm, unilaterally or in coordination with other firms, to sustain materially higher prices than would exist in the absence of the merger by diminishing existing competition. This typically occurs with horizontal mergers when there is direct or existing overlap between the operations of the merging firms. This can also occur with non-horizontal mergers, such as those that foreclose rivals from accessing inputs to production.

Prevention of Competition

2.10 Competition may be substantially prevented when a merger enables the merged firm, unilaterally or in coordination with other firms, to sustain materially higher prices than would exist in the absence of the merger by hindering the development of anticipated future competition. This typically occurs when there is no or limited direct overlap between the merging firms' existing businesses, but direct competition between those businesses was expected to develop or increase in the absence of the merger. It may also occur when there is direct overlap between the merging parties' existing business(es) and the competitive effectiveness of one of the merging firms was expected to increase absent the merger, for example, because of the introduction of an improved product.

2.11 In these circumstances, the Bureau examines whether, absent the merger, timely entry or expansion[11] by either of the merging firms would likely occur on a sufficient scale and with sufficient scope to prevent incumbents from exercising market power.[12] "Timely"

11 Throughout these guidelines, the term "entry" also refers to expansion by existing firms.

12 The terms "timely," "likely" and "sufficient" are discussed in further detail in Part 7, below.

means that such entry would have occurred within a reasonable period of time, given the characteristics and dynamics of the market in question.[13] "Likely" refers to the expectation that entry by one of the merging firms would occur. The Bureau also considers whether effective entry by rival firms is likely, and the impact of such rival entry or expansion on prices. "Sufficient" means that, in the absence of the merger, entry by one of the merging firms would have caused prices to materially decrease. It also encompasses a scenario in which the threat of such entry has prevented a material price increase from occurring. The Bureau may examine a merger in terms of prevention of competition when the merger forestalls the entry plans of the acquirer, the target or a potential competitor, or when the merger removes independent control of capacity or an asset that provides or was likely to provide an important source of competitive discipline.

2.12 The following are examples of mergers that may result in a substantial prevention of competition:

- the acquisition of a potential entrant or of a recent entrant that was likely to expand or become a more vigorous competitor;
- an acquisition by the market leader that pre-empts a likely acquisition of the same target by a competitor;
- the acquisition of an existing business that would likely have entered the market in the absence of the merger;
- an acquisition that prevents expansion into new geographic markets;
- an acquisition that prevents the pro-competitive effects associated with new capacity; and
- an acquisition that prevents or limits the introduction of new products.

Substantiality

2.13 When the Bureau assesses whether a merger is likely to prevent or lessen competition substantially, it evaluates whether the merger is likely to provide the merged firm, unilaterally or in coordination with other firms, with the ability to materially influence price. The Bureau considers the likely magnitude and duration of any price increase that is anticipated to follow from the merger. Generally speaking, the prevention or lessening of competition is considered to be "substantial" in two circumstances:

- the price of the relevant product(s) would likely be materially higher in the relevant market than it would be in the absence of the merger ("material price increase"); and
- sufficient new entry would not occur rapidly enough to prevent the material price increase, or to counteract the effects of any such price increase.

13 Since the harm occasioned by a merger that substantially prevents competition may be sustained over the long term, the Bureau may consider longer time frames when assessing the effects of a prevention of competition than it does when assessing post-merger entry (see Part 7, below).

2.14 The Bureau does not consider a numerical threshold for the material price increase.[14] Instead, it bases its conclusions about whether the prevention or lessening of competition is substantial on an assessment of market-specific factors that could have a constraining influence on price following the merger. Additionally, where the merging firms, individually or collectively, have pre-existing market power, smaller impacts on competition resulting from the merger will meet the test of being substantial.

PART 3: ANALYTICAL FRAMEWORK

3.1 In determining whether a merger is likely to create, maintain or enhance market power, the Bureau must examine the competitive effects of the merger. This exercise generally involves defining the relevant markets and assessing the competitive effects of the merger in those markets. Market definition is not necessarily the initial step, or a required step, but generally is undertaken. The same evidence may be relevant and contribute to both the definition of relevant markets and the assessment of competitive effects. Merger review is often an iterative process in which evidence respecting the relevant market and market shares is considered alongside other evidence of competitive effects, with the analysis of each informing and complementing the other.

3.2 The overall objective of market definition in merger analysis is to identify the set of products that customers consider to be substitutes for those produced by the merging firms and the set or sets of buyers that could potentially face increased market power owing to the merger. Market definition, and the measurement of market share and concentration in the relevant market, is not an end in itself. Consistent with this, section 92(2) of the Act precludes the Tribunal from concluding that a merger is likely to prevent or lessen competition substantially solely on the basis of evidence of concentration or market share. The ultimate inquiry is not about market definition, which is merely an analytical tool – one that defies precision and can thus vary in its usefulness – to assist in evaluating effects. Rather, the ultimate inquiry is about whether a merger prevents or lessens competition substantially. That said, when reviewing a merger, market definition generally sets the context for the Bureau's assessment of the likely competitive effects of a merger.

3.3 In some cases, it may be clear that a merger will not create, preserve or enhance market power under any plausible market definition. Alternatively, it may be clear that anti-competitive effects would result under all plausible market definitions. In both such circumstances, the Bureau need not reach a firm conclusion on the precise metes and bounds of the relevant market(s). Additionally, when a completed merger has resulted in a material price increase, the Bureau may rely on evidence of that increase, taking into account other relevant factors. Cases may also arise in which the choice among several plausible market definitions may have a significant impact on

14 A material price increase is distinct from (and will generally be less than) the "significant and non-transitory price increase" that is used to define relevant markets, as described in Part 4, below. What constitutes a "materially greater" price varies with the industry and the context. For purposes of the statement above, materiality includes not only the magnitude and scope but also the sustainability of the price increase.

market share. In such cases, there may be a greater need for evidence regarding likely competitive effects that is not based on market share and concentration. While the Bureau may elect not to define markets in cases in which other reliable evidence of competitive effects is available, the Bureau will normally identify one or more relevant markets in which competition is prevented or lessened, in any merger enforcement action.

3.4 Section 93 of the Act sets out a non-exhaustive list of discretionary factors that the Tribunal may consider when determining whether a merger prevents or lessens competition substantially, or is likely to do so.[15] These factors, which are largely qualitative, may be relevant to the Bureau's assessment of market definition or of the competitive effects of a merger, or both. These factors are discussed in detail in Parts 4 and 6, below.[16]

3.5 The Bureau may also assess competitive effects from a quantitative perspective using various economic tools. The Bureau has discretion in determining which economic and other analytical tools it uses in particular cases. As the economic tools evolve, so will the Bureau's analytical approach.

3.6 The tools the Bureau uses to assess competitive effects also depend heavily on the facts of each case as well as on the availability of qualitative and quantitative evidence. Qualitative evidence may come from documents created by the merging parties in the ordinary course of business or from first-hand observations of the industry by customers or other market participants. Quantitative evidence may be derived from statistical analyses of price, quantity, costs or other data maintained by the merging parties and/or third parties. In all cases, the Bureau assesses the reliability, robustness and probative value of the evidence gathered.

15 Section 93 provides that the Tribunal "may" have regard to the listed factors, while section 93(*h*) permits the Tribunal to consider any other relevant factor. The Bureau does not consider the section 93 factors in a linear fashion. Rather, these factors form part of the analysis of competitive effects, to the extent they are relevant in a particular case. The Bureau encourages parties in their submissions to focus only on the factors and evidence that are relevant to the assessment of the impact of their merger on competition, rather than to treat the section 93 factors as a "checklist" to address in every case.

16 See also Part 7 on barriers to entry (section 93(*d*)) and Part 13 on "failing firm" (section 93(*b*)).

PART 4: MARKET DEFINITION

Overview

4.1 When the Bureau assesses relevant markets, it does so from two perspectives: the product dimension and the geographic dimension. As a general principle, the Bureau does not assume that the merging parties operate in the same relevant market(s), even when there appears to be some overlap between their products and the geographic areas in which they conduct business. In addition, the relevant market(s) being analyzed for competitive effects may not necessarily correspond to the product categories or service areas established by the merging firms or their rivals for operational purposes.

4.2 Market definition is based on substitutability, and focuses on demand responses to changes in relative prices after the merger. The ability of a firm or group of firms to raise prices without losing sufficient sales to make the price increase unprofitable ultimately depends on buyers' willingness to pay the higher price.[17] The ability of competitive suppliers to respond to a price increase is also important when assessing the potential for the exercise of market power, but the Bureau examines such responses later in the analysis—either when identifying the participants in the relevant market or when examining entry into the relevant market.

4.3 Conceptually, a relevant market is defined as the smallest group of products, including at least one product of the merging parties, and the smallest geographic area, in which a sole profit-maximizing seller (a "hypothetical monopolist") would impose and sustain a small but significant and non-transitory increase in price ("SSNIP") above levels that would likely exist in the absence of the merger.[18] In most cases, the Bureau considers a five percent price increase to be significant and a one-year period to be non-transitory. Market characteristics may support using a different price increase or time period.

4.4 The market definition analysis begins by postulating a candidate market for each product of the merging parties. For each candidate market, the analysis proceeds by determining whether a hypothetical monopolist controlling the group of products in that candidate market would profitably impose a SSNIP, assuming the terms of sale of all other products remained constant.[19] If the price increase would likely cause buyers to switch their purchases to other products in sufficient quantity to render the price increase unprofitable, the postulated candidate market is not the relevant market, and the next-best substitute is added to the candidate market.[20] The analysis

17 The Bureau typically considers product and geographic substitutes that are included in a single relevant market to be "acceptable" within the meaning of section 93(*c*) of the Act. When products within a relevant market are differentiated, some may be closer substitutes than others.

18 A market may consist of a single homogeneous product or a group of differentiated products.

19 Changes in terms of sale of other products in response to the merger are accounted for in the analysis of competitive effects and entry.

20 The next-best substitute is the product that would account for the greatest diversion in demand by buyers

then repeats by determining whether a hypothetical monopolist controlling the set of products in the expanded candidate market would profitably impose a SSNIP. This process continues until the point at which the hypothetical monopolist would impose and sustain the price increase for at least one product of the merging parties in the candidate market. In general, the smallest set of products in which the price increase can be sustained is defined as the relevant product market.

4.5 The same general approach applies to assessing the geographic scope of the market. In this case, an initial candidate market is proposed for each location where a merging party produces or sells the relevant products. As above, if buyers are likely to switch their purchases to sellers in more distant locations in sufficient quantities to render a SSNIP by a hypothetical monopolist unprofitable, the location that is the next-best substitute is added to the candidate market. This process continues until the smallest set of areas over which a hypothetical monopolist would impose and sustain the price increase is identified.

4.6 The base price used to postulate a price increase is typically the prevailing price in the relevant market. The Bureau may elect not to use the prevailing price when market conditions (absent the merger) would likely result in a lower or higher price in the future.[21]

4.7 In general, the base price used to postulate a price increase is whatever is ordinarily considered to be the price of the product in the sector of the industry (e.g., manufacturing, wholesale, retail) being examined.

4.8 In some circumstances, sellers may identify and charge different prices to various targeted sets of buyers ("price discrimination"). Sellers are able to price discriminate when targeted buyers cannot effectively switch to other products or geographic locations, and cannot engage in arbitrage with other buyers by taking advantage of price differences. When price discrimination is feasible, it may be appropriate to define relevant markets with reference to the characteristics of the buyers who purchase the product (assuming they can be delineated) or to the particular locations of the targeted buyers.

4.9 The factors the Bureau considers when analyzing the product and geographic dimensions of market definition are set out below.

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in response to the postulated price increase, assuming that the product is available in unlimited quantities at constant prices.

21 When the evidence suggests a change in the future price (absent the merger) can be predicted with confidence, the Bureau may delineate markets based on the likely future price, even when that future price cannot be predicted precisely.

Product Market Definition

4.10 For the purpose of product market definition, what matters is not the identity of sellers, but the characteristics of the products and buyers' ability or willingness to switch from one product to another in response to changes in relative prices.[22] A relevant product market consists of a given product of the merging parties and all substitutes required for a SSNIP to be profitable.

4.11 When detailed data on the prices and quantities of the relevant products and their substitutes are available, statistical measures may be used to define relevant product markets. Demand elasticities indicate how buyers change their consumption of a product in response to changes in the product's price (own-price elasticity) or in response to changes in the price of another identified product (cross-price elasticity). While cross-price elasticities do not in themselves directly measure the ability of a firm to profitably raise prices, they are particularly useful when determining whether differentiated products are substitutes for one another and whether such products are part of the same relevant market.

4.12 Whether or not reliable statistical evidence on demand elasticities is available, the Bureau considers factors that provide evidence of substitutability, including evidence from market participants and the functional indicators highlighted below.

4.13 The views, strategies and behaviour of buyers are often reliable indicators of whether buyers would likely switch to other products in response to a SSNIP. For example, the Bureau examines what buyers have done in the past and what they are likely to do in the future as options become available, for instance, through advances in technology. Information from industry surveys and industry participants, such as competitors and manufacturers of the relevant product, is also taken into account. This information advances the analysis by providing details on historical developments (including the past behaviour of the merging parties and their rivals) and likely future developments in the industry. Pre-existing documents prepared by the merging parties in the ordinary course of business can also be very useful in this regard.

4.14 Various functional indicators help to determine what products are considered substitutes, including end use, physical and technical characteristics, price relationships and relative price levels, as well as buyer switching costs, as discussed below. Buyers may not view products purchased for similar end uses as substitutes. Therefore, functional interchangeability is not sufficient to warrant inclusion of two products in the same relevant market. In general, when buyers place a high value on the actual or perceived unique physical or technical characteristics of a product (including warranties, post-sales service and order turnaround time), it may be necessary to define distinct relevant markets based on these characteristics.

22 In this context, switching refers to "economic substitutability," defined as a change in consumption patterns in response to a price change, holding all other factors constant.

4.15 Switching costs may discourage a sufficient number of buyers from purchasing products that are functionally interchangeable, thereby allowing a hypothetical monopolist to impose a SSNIP. Products are not included in the same relevant market when costs that must be incurred by buyers are sufficient to render switching unlikely in response to a SSNIP. Examples include costs for buyers to retool, re-package, undertake product testing, adapt marketing materials and strategies, terminate a supply contract, learn new procedures or convert essential equipment. Other costs include the expense (and risk) buyers must incur when a product fails to satisfy expectations, which may damage a buyer's reputation as a reseller, or require the shutdown of a production line.

4.16 A relevant market may consist of a group of diverse products that are not themselves substitutes for each other. This occurs when a sole profit-maximizing seller would increase the price of the group of products because a sufficient number of buyers would not respond to the price increase by purchasing the various components separately from different sellers. This reaction may occur when there are significant transaction costs associated with using a number of sellers, including transportation costs and the time required to negotiate with multiple sellers. In these circumstances, the Bureau's examination includes an assessment of these transaction costs, as well as buyers' propensity to purchase a number of products from a single seller and the extent to which they have in the past broken up their purchases of a group of products in response to relative price changes.

Geographic Market Definition

4.17 For the purpose of geographic market definition, what matters is not the identity of the sellers, but buyers' ability or willingness to switch their purchases in sufficient quantity from suppliers in one location to suppliers in another, in response to changes in relative prices. A relevant geographic market consists of all supply points that would have to be included for a SSNIP to be profitable, assuming that there is no price discrimination (as described in paragraph 4.8 above). When price discrimination is present (and buyers and third parties are unable to arbitrage between low and high price areas), geographic markets are defined according to the location of each targeted group of buyers.

4.18 When defining the boundaries of geographic markets, the Bureau generally relies on evidence of substitutability, including evidence from market participants and the functional indicators described below and, when available, empirical analysis.

4.19 The views, strategies and behaviour of buyers in a given geographic area are often reliable indicators of whether buyers would likely switch their purchases to sellers located in other geographic areas in the event of a SSNIP. For example, the Bureau examines what buyers have done in the past and what they are likely to do in the future as options become available through, for instance, advances in technology. Industry surveys and the views, strategies and behaviour of industry participants also inform the analysis by providing information on how buyers of a relevant product in one geographic area respond or have responded to changes in the price, packaging or servicing of the relevant product in another geographic area. The extent to which merging parties and other sellers take distant sellers into account in their business plans, marketing strategies and other documentation can also be a useful indicator for geographic market definition.

4.20 Various functional indicators can assist in determining whether geographic areas are considered to be substitutes, including particular characteristics of the product, switching costs, transportation costs, price relationships and relative price levels, shipment patterns and foreign competition.

4.21 Several price and non-price factors could affect buyers' ability or willingness to consider distant options. Non-price factors include the fragility or perishability of the relevant product, convenience, frequency of delivery, and the reliability of service or delivery.

4.22 As with product market definition, high switching costs may discourage buyers from substituting between geographic areas. In addition, transportation costs play a central role in defining the geographic scope of relevant markets because they directly affect price. For example, when the price of the relevant product in a distant area plus the cost of transporting it to a candidate geographic market exceeds the price in the candidate market including a SSNIP, the relevant market does not generally include the products of sellers located in the distant area.[23]

4.23 Evidence that prices in a distant area have historically either exceeded or been lower than prices in the candidate geographic market by more than the transportation costs may indicate that the two areas are in separate relevant markets, for reasons that go beyond transportation costs.[24] However, before reaching this conclusion, the Bureau determines whether a SSNIP in the candidate geographic market may change the pricing differential to the point that distant sellers may be able to constrain a SSNIP.

4.24 Significant shipments of the relevant product from a distant area into an area in which a price increase is being postulated may suggest that the distant area is in the relevant geographic market. However, pre-merger shipment patterns do not, by themselves, establish the constraining effect of distant sellers and may be insufficient to justify broadening the geographic market. The Bureau undertakes further analysis to determine whether shipments from the distant area would make the SSNIP unprofitable.

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23 However, distant firms that have excess capacity may in certain circumstances be willing to ship to another market, even when the net price received is less than the price in their own market.

24 For example, the existence of tariffs or other trade-related factors may create price differentials.

Foreign Competition

4.25 Buyers' willingness or ability to turn to foreign sellers may be affected by buyers' tastes and preferences, and by border-related considerations. Buyers may be less willing or able to switch to foreign substitutes when faced with factors such as exchange rate risk, local licensing and product approval regulations, industry-imposed standards, or initiatives to "buy local" owing to difficulties or uncertainties when crossing the border. Conversely, buyers may be more willing to turn to foreign substitutes when they have ample information about foreign products and how to source them, when foreign sellers or their products have already been placed on approved sourcing lists, or when technology licensing agreements, strategic alliances or other affiliations exist between domestic buyers and foreign firms.

4.26 When it is clear that the sales area of the merging parties and that of foreign sellers both belong in the relevant market (because sufficient buyers would be willing to respond to a SSNIP by turning to these sellers), the boundaries of the market are expanded beyond Canada to include the locations of foreign sellers.[25]

Delineating Geographic Boundaries

4.27 The geographic locations of buyers and sellers are relevant to delineating boundaries, particularly when markets are local or regional in nature. The underlying assumption is that profit-maximizing firms make decisions about where to locate based on the density of their buyer base and try to avoid cannibalizing their own sales when they have two or more locations in close proximity. In this way, demand responses are still key determinants of market boundaries. The Bureau may use spatial competition analysis to help delineate the boundaries of localized geographic markets.[26] The methodology for applying spatial competition analysis depends on the characteristics of the industry and the market under consideration.

4.28 It is important to emphasize that market boundaries in respect of either product or geographic markets are not precise in many instances. In addition, constraints on a merged firm's pricing behaviour can come from both inside and outside the relevant market as defined. These issues are discussed further below.

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25 See section 93(*a*) of the Act. In addition to its relevance to market definition, the extent to which foreign products or foreign competitors provide or are likely to provide effective competition is evaluated in the context of the analysis described in Parts 5, 6 and 7, below.

26 When using spatial competition analysis, the Bureau identifies all locations (such as stores, branches, hubs and outlets) of both the merging parties and their product market competitors, to determine how firms' physical locations are situated relative to one another.

PART 5: MARKET SHARES AND CONCENTRATION

5.1 When engaged in a market definition exercise, the Bureau identifies participants in a relevant market to determine market shares and concentration levels. Such participants include (1) current sellers of the relevant products in the relevant geographic markets and (2) sellers that would begin selling the relevant products in the relevant geographic markets if the price were to rise by a SSNIP. In the latter case, the Bureau considers a firm to be a participant in a relevant market when it does not require significant sunk investments to enter or exit the market and would be able to rapidly and profitably divert existing sales or capacity to begin supplying the market in response to a SSNIP (a "supply response").[27] The Bureau considers situations in which competitive sellers would need to incur significant sunk investments, or would not be able to respond rapidly, in the analysis of entry (see Part 7, below).

Calculating Market Shares

5.2 The Bureau calculates market shares for all sellers who have been identified as participants in the relevant market.

5.3 Market shares can be measured in various ways, for example in terms of dollar sales, unit sales, capacity or, in certain natural resource industries, reserves.[28] When calculating market shares, the Bureau uses the best indicators of sellers' future competitive significance. In cases in which products are undifferentiated or homogeneous (i.e., have no unique physical characteristics or perceived attributes), and firms are all operating at full capacity, market shares based on dollar sales, unit sales and capacity should yield similar results. In such situations, the basis of measurement depends largely on the availability of data.

5.4 When firms producing homogeneous products have excess capacity, market shares based on capacity may best reflect a firm's relative market position and competitive influence in the market. Excess capacity may be less relevant to calculating market shares when it is clear that some of a firm's unused capacity does not have a constraining influence in the relevant market (e.g., because the capacity is high-cost capacity or the firm is not effective in marketing its product). When a regulated or historical incumbent firm is facing deregulation or enhanced competition, shares based on new customer acquisitions may be a better indicator of competitive vigor than are shares based on existing customers.

5.5 As the level of product differentiation in a relevant market increases, market shares calculated on the basis of dollar sales, unit sales and capacity increasingly differ. For

27 When merging firms compete across several markets and face the same competitors in each, the Bureau may use an aggregate description of these markets simply as a matter of convenience.

28 Throughout these guidelines, the term "capacity" means the ability to *produce* or *sell* a product. Capacity to sell refers to marketing and distribution capabilities, such as a sales force, distribution networks and other related infrastructure.

example, if most of the excess capacity in the relevant market were held by discount sellers in a highly differentiated market, the market shares of these sellers calculated on the basis of total capacity would be greater than if they were calculated on the basis of actual unit or dollar sales. In this case, market shares based on total capacity would be a misleading indicator of the relative market position of the discount sellers.[29] In such circumstances, dollar sales may be the better indicator of the size of the total market and of the relative positions of individual firms. Because unit sales may also provide important information about relative market positions, the Bureau often requests both dollar sales and unit sales data from the merging parties and other sellers.[30]

5.6 The Bureau generally includes the total output or total capacity of current sellers located within the relevant market in the calculation of the total size of the market and the shares of individual competitors. However, when a significant proportion of output or capacity is committed to business outside the relevant market and is not likely to be available to the relevant market in response to a SSNIP, the Bureau generally does not include this output or capacity in its calculations.

5.7 For firms that participate in the market through a supply response, the Bureau only includes in the market share calculations the output or capacity that would likely become available to the relevant market without incurring significant sunk investments.

Market Share and Concentration Thresholds

5.8 Consistent with section 92(2) of the Act, information that demonstrates that market share or concentration is likely to be high is not, in and of itself, sufficient to justify a conclusion that a merger is likely to prevent or lessen competition substantially. However, information about market share and concentration can inform the analysis of competitive effects when it reflects the market position of the merged firm relative to that of its rivals. In the absence of high post-merger market share and concentration, effective competition in the relevant market is generally likely to constrain the creation, maintenance or enhancement of market power by reason of the merger.

5.9 The Bureau has established the following thresholds to identify and distinguish mergers that are unlikely to have anti-competitive consequences from those that require a more detailed analysis:

29 Similar results occur as the level of differentiation between sellers increases. For instance, two firms may operate with the same capacity (e.g., number of trucks) but have significantly different revenue streams (because one firm may have many buyers along a truck route, i.e., route density). In such cases, market shares based on capacity and revenues provide different information about relative market positions.

30 While publicly available or readily observable information may be useful for estimating market shares, when credible and possible, the Bureau relies on transaction-level data from individual market participants as the most accurate measure of market shares.

- The Commissioner generally will not challenge a merger on the basis of a concern related to the unilateral exercise of market power when the post-merger market share of the merged firm would be less than 35 percent.
- The Commissioner generally will not challenge a merger on the basis of a concern related to a coordinated exercise of market power when
  - the post-merger market share accounted for by the four largest firms in the market (known as the four-firm concentration ratio or CR4) would be less than 65 percent; or
  - the post-merger market share of the merged firm would be less than 10 percent.

5.10 Mergers that give rise to market shares or concentration that exceed these thresholds are not necessarily anti-competitive. Under these circumstances, the Bureau examines various factors to determine whether such mergers would likely create, maintain or enhance market power, and thereby prevent or lessen competition substantially.

5.11 When other information suggests that current market shares do not reflect the competitive role of one of the merging parties relative to its rivals, the Bureau considers this information when determining whether a merger is likely to prevent or lessen competition substantially. In all cases, examining market shares and concentration is only one part of the Bureau's analysis of competitive effects.

5.12 In addition to the level of market shares or concentration in the relevant market, the Bureau examines the distribution of market shares across competitors and the extent to which market shares have changed or remained the same over a significant period of time.

5.13 All else being equal, the likelihood that a number of firms may be able to bring about a price increase through coordinated behaviour increases as the level of concentration in a market rises and as the number of firms declines.[31] In contrast, coordinated behaviour becomes increasingly difficult as the number or size of firms that have the ability to increase output increases.

5.14 When evaluating market share information, the Bureau considers the nature of the market and the impact of forthcoming change and innovation on the stability of existing market shares.[32] While a small incremental increase in concentration following a merger may suggest that the merger is not likely to have a significant impact on the

31 In addition to the CR4, the Bureau may examine changes in the Herfindahl-Hirschman Index ("HHI") (calculated by summing the squares of the individual market shares of all market participants) to observe the relative change in concentration before and after a merger. While the change in HHIs may provide useful information about changes in the market structure, the Bureau does not use HHI levels to delineate any safe harbour threshold.

32 For example, historical or existing market shares may be less relevant in bidding markets in which rapid fluctuations in market shares are more common. In such cases, the analysis focuses on the likely future effectiveness of independent sources of competition, regardless of their current shares. Bidding and bargaining markets are discussed in additional detail under "Unilateral Effects" in Part 6.

market, the Bureau assesses the growth expectations for one or both of the merging parties to determine whether the merger may eliminate an important competitive force.

PART 6: ANTI-COMPETITIVE EFFECTS

6.1 As noted in Part 3, above, the Bureau may consider market definition and competitive effects concurrently in a dynamic and iterative analytical process. When the market share and concentration thresholds listed in paragraph 5.9, above, are exceeded or when other information suggests that a merger may prevent or lessen competition substantially, the Bureau's assessment of competitive effects based on quantitative analysis and the application of relevant factors, including the factors listed in section 93 of the Act, takes on greater importance. Such an assessment falls under the broad categories of unilateral effects and coordinated effects, as described below.

6.2 When it is clear that the level of effective competition that is to remain in the relevant market is not likely to be reduced as a result of the merger, this alone generally justifies a conclusion not to challenge the merger.

6.3 To determine the ability and effectiveness of remaining competitors to constrain an exercise of market power by the merged firm, the Bureau examines existing forms of rivalry, such as discounting and other pricing strategies, distribution and marketing methods, product and package positioning, and service offerings. Whether the market shares of firms are stable or fluctuate over time is also relevant, as is the extent to which product differentiation affects the degree of direct competition among firms. Further, the Bureau assesses whether competitors are likely to remain as vigorous and effective as they were prior to the merger.

6.4 The extent and quality of excess capacity held by merging and non-merging firms provides useful information about whether the merger could result in the exercise of market power. Excess capacity held by rivals to the merged firm improves their ability to expand output should the merged firm attempt to exercise market power. On the other hand, when the merged firm holds a significant share of excess capacity in the relevant market, this may discourage rivals from expanding.

6.5 The Bureau assesses the competitive attributes of the target business to determine whether the merger will likely result in the removal of a vigorous and effective competitor.[33] In addition to the forms of rivalry discussed above, the Bureau's assessment includes consideration of whether one of the merging parties:

33 See section 93(*f*) of the Act. A firm that is a vigorous and effective competitor often plays an important role in pressuring other firms to compete more intensely with respect to existing products or in the development of new products. A firm does not have to be among the larger competitors in a market in order to be a vigorous and effective competitor. Small firms can exercise an influence on competition that is disproportionate to their size. Mavericks (described in "Coordinated Effects," in Part 6, below) are one type of vigorous and effective competitor.

- has a history of not following price increases or market stabilizing initiatives by competitors, or of leading price reductions;
- provides unique service, warranty or other terms to the market;
- has recently expanded capacity or has plans to do so;
- has recently made gains in market share or is in a position to do so; or
- has recently acquired intellectual property rights or other inputs, or has developed product features that enhance its ability to compete in the market, or will soon do so.

6.6 While the removal of a vigorous and effective competitor through a merger is likely to prevent or lessen competition to some degree, it may not, in itself, provide a sufficient basis for a decision to challenge the merger. Additionally, when a firm removed through a merger is not a vigorous or effective competitor (e.g., owing to financial distress, or declining technologies or markets), this fact is relevant to, but not determinative of, a decision not to challenge a merger.

6.7 The Bureau evaluates the general nature and extent of change and innovation in a market.[34] In addition to assessing the competitive impact of technological developments in products and processes, the Bureau examines change and innovation in relation to distribution, service, sales, marketing, packaging, buyer tastes, purchase patterns, firm structure, the regulatory environment and the economy as a whole.

6.8 The pressures exerted by change and innovation on competitors in a market (including the merging parties) may be such that a material price increase is unlikely to be sustainable, especially when technology or a merger reduces barriers to entry or stimulates or accelerates the change or innovation in question. Such pressures may have important implications for efficient markets in the medium to long term.

6.9 A merger may facilitate the exercise of market power by impeding the process of change and innovation. For example, when a merger eliminates an innovative firm that presents a serious threat to incumbents, the merger may hinder or delay the introduction of new products, processes, marketing approaches, and aggressive research and development initiatives or business methods.

Unilateral Effects

6.10 By placing pricing and supply decisions under common control, a merger can create an incentive to increase price and restrict supply or limit other dimensions of competition. A unilateral exercise of market power occurs when the merged firm can profitably sustain a material price increase without effective discipline from competitive responses by rivals.

6.11 When buyers can choose from among many sellers offering comparable products, a firm's ability to profitably increase its price is limited by buyers diverting their

34 See section 93(*g*) of the Act.

purchases to substitute products in response to the price increase. When two firms in a market merge and the price of one firm's product(s) rises, some demand may be diverted to product(s) of the firm's merger partner, thereby increasing the overall profitability of the price increase and providing the impetus to raise the price. As such, the elimination of competition between firms as a result of a merger may lessen competition substantially.

6.12 Unilateral effects can occur in various market environments, defined by the primary characteristics that distinguish the firms within those markets and determine the nature of their competition. Three types of market environment are described below.

Firms in Differentiated Product Industries

6.13 In markets in which products are differentiated, a merger may create, enhance or maintain the ability of the merged firm to exercise market power unilaterally when the product offerings of the merging parties are close substitutes for one another. In such circumstances, the Bureau assesses how the merger may change the pricing incentives of the individual firms.

6.14 Any firm considering increasing the prices for its products faces a trade-off between higher profits on the sales that it continues to make following the price increase and the profits that it loses on sales that it no longer makes following the price increase, as buyers switch to other firms and/or other products. Any sales that were previously lost to the firm's merging partner will be captured by the merged firm ("diverted sales"). Thus, the incentives to raise prices after the merger are greater the more closely the products of the merging firms compete with each other, and the larger the profit margins on these diverted sales.

6.15 The closeness of competition between the merging firms' products may be measured by the diversion ratio between them.[35] The value of the diverted sales from one merging firm depends on the volume of diverted sales and the profit margin on the diverted sales. The greater the value of the diverted sales, the greater the incentive the merged firm has to raise prices.

6.16 The incentive to raise prices following the merger will typically be greater when the products of the merging firms are close substitutes for a significant number[36] of buyers, when the merger removes a vigorous and effective competitor from the market, or when buyers are not very sensitive to price increases.[37] These are not the only circumstances, however, when the Bureau may be concerned with potential unilateral effects post-merger.

35 The diversion ratio between firm A's product and firm B's product is equal to the fraction of sales lost by firm A to firm B when firm A raises the price of its product. Similarly, the diversion ratio between firm B's product and firm A's product is equal to the fraction of sales lost by firm B to firm A when firm B raises the price of its product. The diversion ratios between firms A and B need not be symmetric.

36 A significant number" in this context need not approach a majority.

37 Buyer sensitivity to price increases may but need not be measured by the own-price elasticity of demand.

6.17 Even when the merging firms are found to have an incentive to increase price after the merger, the likelihood of the merger preventing or lessening competition substantially also depends on the responses of buyers and rival firms. In addition to considering the value of sales currently diverted to rivals, the Bureau evaluates the likely competitive responses of rivals, including whether rivals in the market are likely to expand production, reposition their products or extend their product line to discipline unilateral market power that would otherwise occur as a result of the merger.[38] The Bureau also considers existing sellers that may only occupy a particular niche within the relevant market and whether they provide an alternative for a sufficient number of buyers. In addition, the likelihood and likely impact of entry is considered.

6.18 When assessing the extent of competition between the products of the merging firms, the Bureau examines, among other possible factors, past buyer-switching behaviour in response to changes in relative prices, information based on buyer preference surveys, win-loss records, and estimates of own-price and cross-price elasticities.[39]

Firms in Homogeneous Product Industries

6.19 A post-merger price increase may be profitable if the merger were to remove a seller to whom buyers would otherwise turn in response to a price increase. In markets in which products are relatively undifferentiated (that is, they are homogeneous), such a price increase is more likely to be profitable

- the greater the share of the relevant market the merged firm accounts for;
- the lower the margin on the output that the merged firm withholds from the market to raise price;
- the less sensitive buyers are to price increases; and
- the smaller the response of other sellers offering close substitutes.

6.20 The response of other sellers will be smaller when they have insufficient capacity to increase sales to replace the output withheld by the merged firm post-merger, or substantial amounts of capacity are committed to other buyers under long-term contracts, and capacity cannot be expanded quickly and at relatively low cost. Therefore, the Bureau examines, among other factors, whether capacity constraints limit the effectiveness of remaining sellers by impeding their ability to make their products available in sufficient quantities to counter an exercise of market power by the merged firm.

Bidding and Bargaining Markets

6.21 In some markets, sellers may interact with buyers through bidding or bargaining for the right to supply. Buyers may negotiate with multiple sellers as a means of using one seller to obtain a better price from another seller. Such interactions may take the form of a pure auction or involve repeated rounds of negotiation with a select group

38 This requires a determination of whether expansion, repositioning or product line extension will likely be deterred by risk, sunk costs or other entry barriers.

39 Refer to definitions of own-price and cross-price elasticity in paragraph 4.11, above.

of sellers. A merger between two sellers will prevent buyers from playing these two sellers off against each other to obtain a better price.

6.22 The extent to which this loss of competition will affect the price paid by the buyer depends on how close the merging firms are to each other relative to other bidders and potential suppliers in meeting the buyer's requirements. When there are many bidders or potential suppliers that are equally or similarly situated as the merging parties, a merger involving two sellers is unlikely to prevent or lessen competition substantially.[40]

Coordinated Effects

6.23 A merger may prevent or lessen competition substantially when it facilitates or encourages coordinated behaviour among firms after the merger. The Bureau's analysis of these coordinated effects entails determining how the merger is likely to change the competitive dynamic in the market such that coordination is substantially more likely or effective. A lessening or prevention of competition may result from coordinated behaviour even when the coordination does not involve all the firms in the market.

6.24 Coordination involves interaction by a group of firms (including the merged firm) that is profitable for each firm because of each firm's accommodating reactions to the conduct of the others. Coordinated behaviour may relate to price, service levels, allocation of customers or territories, or any other dimension of competition.

6.25 Coordinated behaviour may involve tacit understandings that are not explicitly negotiated or communicated among firms. Tacit understandings arise from mutual yet independent recognition that firms can, under certain market conditions, benefit from competing less aggressively with one another. Coordinated behaviour may also involve express agreements among firms to compete less vigorously or to refrain from competing. Such agreements may raise concerns under the conspiracy and bid-rigging provisions of the Act.

6.26 Coordinated behaviour is likely to be sustainable only in the following circumstances:

- when firms are able to
  - individually recognize mutually beneficial terms of coordination;
  - monitor one another's conduct and detect deviations from the terms of coordination; and
  - respond to any deviations from the terms of coordination through credible deterrent mechanisms;[41] and

40 As noted in footnote 32 above, historical or existing market shares may be less relevant in bidding markets.

41 These responses, typically known as punishments, may take the form of lowering prices in the relevant market or in other markets.

- when coordination will not be threatened by external factors, such as the reactions of existing and potential competitors not part of the coordinating group of firms or the reactions of buyers.

6.27 Competition is likely to be prevented or lessened substantially when a merger materially increases the likelihood of coordinated behaviour when none existed before, or materially increases the extent or effectiveness of coordination beyond that which already exists. When making this assessment, the Bureau considers a number of factors, including the presence of factors necessary for successful coordination and those that are conducive to coordination. The mere presence of such factors, however, is not sufficient to conclude that there are competition concerns. Rather, at issue is whether the merger impacts these factors in such a way that makes coordination or more effective coordination more likely.

Market Concentration and Entry Barriers

6.28 Market power typically arises in markets characterized by concentration and high barriers to entry. Market concentration is generally a necessary but not sufficient condition for a merger to prevent or lessen competition substantially through coordinated effects. Firms in a concentrated market typically find it easier and less costly to engage in coordinated behaviour because it is easier for members of a small group of firms to recognize terms of coordination, and to monitor one another's conduct and detect and respond to deviations. Barriers to entry are also relevant, since coordinated behaviour among competitors in a concentrated market would unlikely be sustainable if raising prices were to lead to significant effective entry.

Indicia Suggesting that Market Conditions are Conducive to Coordination

6.29 In its analysis of competitive effects, the Bureau examines whether market conditions would likely allow coordinated behaviour to be sustainable after the merger, with reference to the criteria outlined in paragraph 6.26, above. While the presence of certain market conditions (often referred to as facilitating factors) may suggest the ability of firms to overcome impediments to coordinated behaviour, neither the absence nor the presence of any single factor or group of factors determines whether competition is likely to be prevented or lessened substantially.

6.30 When examining whether firms are likely able to independently recognize mutually beneficial terms of coordination, the Bureau considers, among other factors, the degree of product differentiation and cost symmetries among firms. Recognizing terms of coordination that all firms find profitable is easier when products are less differentiated and when firms have similar cost structures. Complex products and differences in product offerings and cost structure tend to make it more difficult for firms to reach profitable terms of coordination. Similarly, markets with rapid and frequent product innovations, or that are in a period of rapid growth, are less conducive to coordinated behaviour.

6.31 Profit-maximizing firms have an incentive to deviate from coordinated behaviour when the expected profits from deviating are greater than the expected profits from engaging in coordination. Therefore, when evaluating whether coordination is likely, the Bureau considers whether certain firms have stronger incentives to deviate as well as factors that could affect incentives to deviate, such as the size and frequency of transactions. When individual transactions are large and infrequent relative to total market demand, deviations from coordinated behaviour are more profitable, making effective coordinated behaviour less likely. Additionally, when individual transactions are large relative to a single firm's total output, this will increase that firm's incentive to deviate from coordinated behaviour.[42]

6.32 The Bureau also considers whether firms can monitor and detect deviations from coordinated behaviour. When so doing, the Bureau evaluates the degree of market transparency that exists. When information about prices, rival firms and market conditions is readily available to market participants, it is easier for rivals to monitor one another's behaviour, which in turn makes effective coordination more likely. The existence of industry organizations that facilitate communication and dissemination of information among market participants may also make it easier for firms to coordinate their behaviour. A complex, multi-stage procurement process may affect the ability of firms to detect deviations from coordinated agreements. Also relevant to the analysis is the stability of firms' underlying costs, as well as the predictability of demand. When costs fluctuate, it may be difficult to detect whether a price change represents a deviation from coordinated behaviour or whether it is a response to a change in cost conditions, which, in turn, makes effective coordination less likely. It may similarly be difficult to detect whether a price change represents a deviation from coordinated behaviour when demand fluctuates unexpectedly.

6.33 The Bureau's evaluation of whether firms can impose credible punishments includes assessing the degree of multi-market exposure among firms and of excess capacity.[43] When firms participate in multiple geographic or product markets, there are greater opportunities for them to discourage deviation from coordinated behaviour because there is broader scope for punishing deviations. Similarly, excess capacity held by firms within the coordinating group can allow such firms to oversupply the market when they detect deviations from the coordinated price, thereby discouraging deviations and making coordination more likely. However, excess capacity may also provide firms with an incentive and an ability to deviate from coordinated behaviour by selling products at lower prices. This could, in turn, make coordinated behaviour less likely. It is therefore important to consider which firms, if any, hold excess capacity as well as their individual economic incentives. A firm may also adopt pricing policies, such

42 These examples assume that coordination does not involve a customer allocation scheme.

43 This includes information about levels of service, innovation initiatives, product quality, product choice and levels of advertising. Market transparency is typically increased by posted pricing, circulation of price books, product, service or packaging standardization, exchanges of information regarding matters such as pricing, output, innovation, bids won and lost, and advertising levels, through a trade association, trade publication or otherwise, public disclosure of this information by buyers or through government sources, and "meet the competition" or "most favoured customer" clauses in contracts.

as most-favoured customer clauses, that commit it to following a low-pricing strategy when other firms reduce their prices.

6.34 A history of collusion or coordination in the market is also relevant to the Bureau's analysis, because previous and sustained collusive or coordinated behaviour indicates that firms have successfully overcome the hurdles to effective coordinated behaviour in the past.

Impact of the Merger on Coordinated Behaviour

6.35 When assessing whether a merger increases the likelihood of coordination, the Bureau considers whether the merger changes the competitive dynamic in a market so as to make coordinated behaviour among firms more likely or effective. A merger that changes the competitive dynamic among firms may lead to coordinated behaviour when none existed prior to the merger, or may materially increase the extent or effectiveness of coordination beyond that which already exists in a market. The Bureau determines whether market conditions are conducive to coordination before the merger and whether the merger is likely to increase the likelihood of coordination. The Bureau also identifies the constraints on coordinated behaviour that existed before the merger to determine whether the merger reduces or eliminates those constraints.

6.36 In highly concentrated markets, effective coordination may be constrained by the number of firms that exist before the merger. A merger could remove this constraint by reducing the number of rivals to the point that the profitability of coordination makes coordination a more achievable strategy than it was prior to the merger.

6.37 When firms differ greatly from one another, effective coordination may be constrained by their inability to behave in a way that each finds profitable. When the effect of the merger is to reduce or eliminate asymmetries between the merged firm and its key rivals, firms may find it easier to coordinate their behaviour in a way that is profitable for each coordinating firm after the merger. Conversely, a merger may increase asymmetries between the merged firm and its rivals, thereby making coordinated behaviour less profitable and therefore less likely.

6.38 Effective coordination may be constrained before the merger by the activities of a particularly vigorous and effective competitor (a "maverick"). A maverick is a firm that plays a disruptive role and provides a stimulus to competition in the market. An acquisition of a maverick may remove this constraint on coordination and, as such, increase the likelihood that coordinated behaviour will be effective.

6.39 Alternatively, a merger may not remove a maverick but may instead inhibit a maverick's ability to expand or enter, or otherwise marginalize its competitive significance, thereby increasing the likelihood of effective coordination.

PART 7: ENTRY

7.1 A key component of the Bureau's analysis of competitive effects is whether timely entry[44] by potential competitors would likely occur on a sufficient scale and with sufficient scope to constrain a material price increase in the relevant market. In the absence of impediments to entry, a merged firm's attempt to exercise market power, either unilaterally or through coordinated behaviour with its rivals, is likely to be thwarted by entry of firms that

- are already in the relevant market and can profitably expand production or sales;
- are not in the relevant market but operate in other product or geographic markets and can profitably switch production or sales into the relevant market; or
- can profitably begin production or sales into the relevant market de novo.

Conditions of Entry

7.2 Entry is only effective in constraining the exercise of market power when it is viable. When entry is likely, timely and sufficient in scale and scope, an attempt to increase prices is not likely to be sustainable as buyers of the product in question are able to turn to the new entrant as an alternative source of supply.

Timeliness

7.3 The Bureau's assessment of the conditions of entry involves determining the time that it would take for a potential entrant to become an effective competitor in response to a material price increase that is anticipated to arise as a result of the merger. In general, the longer it takes for potential entrants to become effective competitors, the less likely it is that incumbent firms will be deterred from exercising market power. For that deterrent effect to occur, entrants must react and have an impact on price in a reasonable period of time. In the Bureau's analysis, the beneficial effects of entry on prices in this market must occur quickly enough to deter or counteract any material price increase owing to the merger, such that competition is not likely to be substantially harmed.

Likelihood

7.4 When determining whether future entry is likely to occur, the Bureau generally starts by assessing firms that appear to have an entry advantage. While other potential sources of competition may also be relevant, typically the most important sources of potential competition are the following:

- fringe firms already in the market;
- firms that sell the relevant product in adjacent geographic areas;

44 As noted previously, throughout these guidelines, the term "entry" also refers to expansion by existing firms. The same factors that constrain new entrants also often constrain significant expansion by fringe firms, even though in many cases expansion costs for existing firms may be lower than entry costs for a new entrant.

- firms that produce products with machinery or technology that is similar to that used to produce the relevant product;
- firms that sell in related upstream or downstream markets;
- firms that sell through similar distribution channels; and
- firms that employ similar marketing and promotional methods.

7.5 A history of entry into and exit from a particular market provides insight into the likelihood of entry occurring in a timely manner and on a sufficient scale to counteract an exercise of market power by a merged firm. It is, however, not the sole determinant of whether this would likely occur.

7.6 The Bureau seeks to determine the extent that entry is likely, given the commitments that potential entrants must make, the time required to become effective competitors, the risks involved and the likely rewards. The Bureau considers any delay or loss that potential entrants expect to encounter before becoming effective competitors, and the resulting sunk costs and risk associated with such entry that reduce the likelihood that entry will occur or be successful. The Bureau also considers the expectations that potential entrants may have of incumbent responses to entry, as well as the likelihood that customers will support an entrant's investments or guarantee it a needed volume of sales. When assessing the likelihood of entry, the Bureau evaluates profitability at post-entry prices, taking into account the effect that new supply would have on market prices. These prices are often the pre-merger price levels. For instance, if a competitor was able to enter a market only on a scale that is below the minimum viable scale, the Bureau would not consider such entry to be likely, since the entrant would be unable to achieve the annual level of sales necessary to achieve profitability at post-entry prices.

Sufficiency

7.7 When considering whether entry is likely to be on a scale and scope that would be sufficient to deter or counteract a material price increase, the Bureau examines what would be required from potential competitors who choose to enter. The Bureau will also consider any constraints or limitations on new entrants' capacities or competitive effectiveness. Entry by firms that seek to differentiate themselves by establishing a niche to avoid direct competition with the merged firm may also not be sufficient to constrain an exercise of market power.

Types of Barriers to Entry

7.8 Barriers to entry affect the timeliness, likelihood and sufficiency of entry. They can take many forms, ranging from absolute restrictions that preclude entry, to sunk costs and other factors that raise the costs and risks associated with entry and thereby deter it.[45] While, in some cases, each individual "barrier" may be insufficient alone to impede entry, the Bureau considers the collective influence of all barriers which, when taken together, can effectively deter entry.

45 While commencing a business may in some cases be easy, new entrants may find it difficult to survive for a variety of reasons, including the strategic behaviour of incumbents.

Regulatory Barriers

7.9 The types of barriers identified in section 93(*d*) of the Act—namely tariff and non-tariff barriers to international trade, interprovincial barriers to trade and regulatory control over entry—can provide incumbents with absolute cost advantages over potential entrants, presenting considerable and, in some cases, insurmountable impediments to entry.

Sunk Costs

7.10 Substantial sunk costs directly affect the likelihood of entry and constitute a significant barrier to entry. Costs are sunk when they are not recoverable if the firm exits the market. In general, since entry decisions are typically made in an environment in which success is uncertain, the likelihood of significant future entry decreases as the absolute amount of sunk entry costs relative to the estimated rewards of entry increases. The Bureau's assessment of sunk costs also focuses on the time required to become an effective competitor and the probability of success, and whether these factors justify making the required investments.

7.11 New entrants must often incur various start-up sunk costs, such as acquiring market information, developing and testing product designs, installing equipment, engaging personnel and setting up distribution systems. New entrants may also face significant sunk costs owing to the need to

- make investments in market-specific assets and in learning how to optimize the use of these assets;
- overcome product differentiation-related advantages enjoyed by incumbents; or
- overcome disadvantages presented by the strategic behaviour of incumbents.

7.12 These potential sources of sunk costs can create significant impediments to entry when they require that potential entrants factor greater costs into their decision-making relative to incumbents who can ignore such costs in their pricing decisions because they have already made their sunk cost commitment.

7.13 The investment required to establish a reputation as a reliable or quality seller is also a sunk cost, constituting a barrier to entry when it is an important element in attracting buyers, particularly in industries in which services are an important element of the product. Under these circumstances, the time to establish a good reputation may make profitable entry more difficult, and therefore delay the competitive impact that an entrant may have in the marketplace.

7.14 Long-term exclusive contracts with automatic renewals, rights of first refusal, most favoured customer or "meet or release" clauses or termination fees may constitute barriers to entry. Contracts with attributes that limit buyer switching may make it difficult for firms to gain a sufficient buyer base to be profitable in one or more markets (even when barriers to entry in the industry are otherwise relatively low) and can thus make entry unattractive. The deterring effects of such contracts are more pronounced when, for example, economies of density or scale are important and make it difficult for new or smaller firms to achieve a minimum efficient scale of operations.

Other Factors That Deter Entry

7.15 In markets in which economies of scale are significant, entry on a small scale may be difficult unless the entrant can successfully exploit a niche. Conversely, entry in such markets on a large scale may expand available capacity to supply beyond market demand, thereby depressing market prices and making entry less attractive.

7.16 Market maturity can also impede entry. Entry may be less difficult and time-consuming in the start-up and growth stages of a market, when the dynamics of competition generally change more rapidly. Mature markets exhibit flat or declining demand, making it more difficult for potential entrants to profitably enter the business because the entrants' sales have to come from existing rivals.

7.17 Other cost advantages for incumbents that may deter entry include those related to transportation costs, control over access to scarce or non-duplicable resources such as technology, land, natural resources and distribution channels, network effects, and capital costs.[46]

PART 8: COUNTERVAILING POWER

8.1 When determining whether a merger is likely to result in a material price increase, the Bureau assesses whether buyers are able to constrain the ability of a seller to exercise market power. This may occur when, for example,

- they can self-supply through vertical integration into the upstream market;
- the promise of substantial orders can induce expansion of an existing smaller supplier and/or can sponsor entry by a potential supplier not currently in the market;
- they can refuse to buy other products produced by the seller;
- they can refuse to purchase the seller's products in other geographic markets where the competitive conditions are different; or
- they can impose costs on the seller (for example, by giving less favourable retail placement to the merged entity's products).

8.2 The Bureau does not presume that a buyer has the ability to exercise countervailing power merely by virtue of its size. There must be evidence that a buyer, regardless of size, will have the ability and incentive to constrain an exercise of market power by the merged firm. Evidence of prior dealings between the buyer and one or more of the merging parties that tends to demonstrate the buyer's relative bargaining strength is of particular relevance. The Bureau also considers the extent to which

46 The need to raise capital may have a significant impact on the likelihood and timeliness of entry.

the merger affects the buyer's ability and incentive to exercise countervailing power. When a merger eliminates a supplier whose presence contributed significantly to a buyer's historical bargaining strength, the buyer may no longer be able to exercise countervailing power after the merger.

8.3 When price discrimination is a feature of the relevant market, it may be possible for some but not all buyers to counter the effects of an exercise of market power. For example, a merged firm may be able to increase prices to buyers that do not have the option to vertically integrate their operations, while other buyers with this option may be able to resist such a price increase. Where only a subset of buyers is able to counter a price increase or other exercise of market power, the Bureau will generally find that countervailing power is insufficient to prevent the merged firm from exercising market power in the relevant market.

PART 9: MONOPSONY POWER

9.1 A merger of competing buyers may create or enhance the ability of the merged firm, unilaterally or in coordination with other firms, to exercise monopsony power. The Bureau is generally concerned with monopsony power when a buyer holds market power in the relevant purchasing market, such that it has the ability to decrease the price of a relevant product below competitive levels with a corresponding reduction in the overall quantity of the input produced or supplied in a relevant market, or a corresponding reduction in any other dimension of competition.[47]

9.2 Consistent with its general analytical framework for merger review, the Bureau considers both market definition-based and other evidence of competitive effects in monopsony cases. The conceptual basis used for defining relevant markets is, mirroring the selling side, the hypothetical monopsonist test. A relevant market is defined as the smallest group of products and the smallest geographic area in which a sole profit-maximizing buyer (a "hypothetical monopsonist") would impose and sustain a significant and non-transitory price decrease below levels that would likely exist in the absence of the merger. The relevant product market definition question is thus whether suppliers, in response to a decrease in the price of an input, would switch to alternative buyers or reposition or modify the product they sell in sufficient quantity to render the hypothetical monopsonist's price decrease unprofitable.

9.3 In order to determine market shares and concentration levels, the Bureau compares the size of the purchases of the relevant product by the merging parties with the total sales of the relevant product. When the merging parties represent only a small percentage of the total purchases of the relevant product, the Bureau generally considers the suppliers to be well-placed to forego sales to the merging parties in

47 Cases where the supply curve is perfectly inelastic, such that a price decrease below competitive levels does not result in a decrease in output but only a wealth transfer, may also give rise to concerns. This scenario should be understood to be generally included in the category of monopsony. Similarly, an output effect is not required in monopoly cases.

favour of other buyers when faced with an attempt to lower prices. As a general rule, the Bureau will not challenge a merger based on monopsony (or oligopsony) power concerns where shares of the relevant upstream market held by the merging parties (and their competitors, in an oligopsony case) fall below the market share safe harbours set out in Part 5 of these guidelines. When the merging parties account for a significant portion of purchases of the relevant product and exceed these market share safe harbours, then it is more likely that the merging parties could exercise monopsony power. In this case, the Bureau considers barriers to entry that may limit or negate the ability of a new buyer to purchase the product, or of an existing buyer to expand its purchases (see Part 7 for a detailed discussion of the Bureau's approach to assessing entry).

9.4 When the merged firm accounts for a significant portion of purchases of the relevant product, and barriers to buying the input are high, the factors that the Bureau considers when attempting to determine whether the merged firm is likely to have the ability to exercise monopsony power include the following:

- whether the merged firm can restrict its purchases by an amount that is large enough to reduce the relevant product's price in the market;
- whether upstream supply of the relevant product is characterized by a large number of sellers and low barriers to entry into buying such that the normal selling price of a supplier is likely competitive;
- whether it seems likely that certain suppliers will exit the market or otherwise reduce production, or will reduce investments in new products and processes in response to the anticipated price decrease;
- whether a reduction in the merged firm's purchases of the relevant (input) product is likely to reduce the profits earned by the merged firm in downstream output markets, and, if so, whether the downstream output profit reduction is large enough to reduce the merged firm's incentive to restrict its purchases; and
- whether a reduction in the merged firm's purchases of the relevant product is likely to reduce its access to adequate supply of the relevant product in the long run.

9.5 When available, the Bureau considers empirical evidence to analyze the effect of historical changes in supply on price and quantity as part of the assessment of whether the merging parties would have the ability to exercise monopsony power.

PART 10: MINORITY INTEREST TRANSACTIONS AND INTERLOCKING DIRECTORATES

10.1 Part 1, above, outlines the factors the Bureau considers when determining whether a minority interest transaction or interlocking directorate confers the requisite level of influence to constitute a merger. Additionally, a minority interest or interlocking directorate may be ancillary to a merger that the Bureau is otherwise reviewing (e.g., when one of the merging parties holds a minority interest in a third competitor prior to the merger).[48] This Part outlines the Bureau's approach to minority interest transactions where the Bureau has jurisdiction under the merger provisions of the Act.

10.2 The Bureau's analysis of minority interests and interlocks that are determined to be mergers under Part 1 of these guidelines involves two distinct steps:

- First, the Bureau conducts a preliminary examination of the transaction as a full merger between the acquirer and the target firm. This exercise is used to screen out benign cases. When the Bureau concludes that a full merger would not likely prevent or lessen competition substantially[49], then a more detailed analysis of the minority interest or interlocking directorate is not generally required.
- When, based on its preliminary examination, the Bureau determines that a full merger would raise possible competition concerns, it then moves to the second step in its analysis, in which it (1) examines the specific nature and impact of the minority shareholding and/or interlocking directorate; and (2) conducts a detailed examination of the likely competitive effects arising from the minority shareholding and/or interlocking directorate.

10.3 A minority interest or interlocking directorate may impact competition by affecting the pricing or other competitive incentives of the target, the acquirer or both. Note that, with respect to interlocking directorates, the Bureau is not generally concerned when board representation in these circumstances occurs solely through "independent" directors when the businesses do not compete.

48 As noted in paragraph 1.16, above, an interlocking directorate alone would rarely constitute a merger although it could; however, interlocks are often features of partial interest transactions that otherwise qualify as a merger. The Bureau considers features of any interlock in its assessment of the competitive effects of a merger. Of particular relevance are the following factors: relationship between the interlocked firms, the role and duty of the interlocked director toward the interlocked firms, board composition and the position of the interlocked director on the boards, information to which the interlocked director has access, any special powers of the interlocked director, including voting or veto rights, and any contractual or practical mechanisms that the interlocked director might use to influence firm policies or decision-making.

49 As noted below in paragraph 12.3, in reviewing a full merger the Bureau may make an assessment of whether the efficiency gains that are likely to be brought about by the merger will be greater than and will offset the anti-competitive effects of that merger. By contrast, minority interest transactions typically do not involve the integration of firms and therefore efficiency gains are not typically considered by the Bureau in reviewing minority interests.

10.4 When assessing the target's pricing or other competitive incentives, the Bureau first considers whether, by virtue of its ability to materially influence the economic behaviour of the target business, the acquirer or interlocked director may induce the target business to compete less aggressively. The Bureau also considers the extent of such influence and the likelihood that competition will be prevented or lessened as a result of its exercise.

10.5 Second, the Bureau considers whether the transaction provides the acquirer or the firm with the interlocked director access to confidential information about the target business. In particular, the Bureau examines the likelihood that such access may facilitate coordination between the two firms, may affect the unilateral competitive conduct of the firm that receives the information, or both.

10.6 With respect to the acquirer, the Bureau considers whether a minority interest or interlock may result in a change to the acquirer's pricing or other competitive incentives. A firm that holds a minority position in a target business that is a competitor might have a reduced incentive to compete with the target business because if the acquirer raises its price and consequently loses sales, it will benefit, through its minority interest, from sales that flow to the target business. In effect, the acquirer will recapture some of the sales diverted to the target business and may thus have a greater incentive to raise its own price than it would absent the minority interest. In its assessment, the Bureau considers the extent of diversion between the acquiring and target firms' products and the profits earned on these diverted sales. The Bureau also examines the likelihood, significance and impact of any such change to the incentives of the acquirer.

PART 11: NON-HORIZONTAL MERGERS

11.1 A horizontal merger is a merger between firms that supply competing products. By contrast, non-horizontal mergers involve firms that do not supply competing products. The two main types of non-horizontal mergers are vertical mergers and conglomerate mergers. A vertical merger is a merger between firms that produce products at different levels of a supply chain (e.g., a merger between a supplier and a customer). A conglomerate merger is a merger between parties whose products do not compete, actually or potentially[50], and are not vertically related. Conglomerate mergers may involve products that are related because they are complementary (e.g., printers and ink cartridges),[51] or because customers buy them together owing to purchasing economies of scale or scope.

50 Mergers between potential competitors are dealt with as prevention of competition cases. See paragraphs 2.10-2.12 above.

51 That is, the goods are economic complements, such that the quantity demanded of one product decreases as the price of the other increases.

11.2 Non-horizontal mergers are generally less likely to prevent or lessen competition substantially than are horizontal mergers. This is because non-horizontal mergers may not entail the loss of competition between the merging firms in a relevant market. Non-horizontal mergers also frequently create significant efficiencies.[52] However, non-horizontal mergers may reduce competition in some circumstances, as outlined below.

11.3 The civil provisions of the Act may be available to address conduct by the merged firm that constitutes a refusal to deal, an abuse of dominance or other reviewable conduct. However, where the Bureau is able to remedy or enjoin a merger that is likely to substantially prevent or lessen competition, it will generally do so in preference to pursuing post-merger remedies under other provisions of the Act.

Unilateral Effects of Non-Horizontal Mergers

11.4 A non-horizontal merger may harm competition if the merged firm is able to limit or eliminate rival firms' access to inputs or markets, thereby reducing or eliminating rival firms' ability or incentive to compete. The ability to affect rivals (and, by extension, competition) in this manner is referred to in these guidelines as "foreclosure."

11.5 Foreclosure may be partial when the merged firm, for example, raises its price to a downstream competitor, thereby raising its rival's costs. Foreclosure may be complete when the merged firm, for example, refuses to supply a downstream competitor.

11.6 When examining the likely foreclosure effects of a non-horizontal merger transaction, the Bureau considers three inter-related questions: (1) whether the merged firm has the ability to harm rivals; (2) whether the merged firm has the incentive (i.e., whether it is profitable) to do so; and (3) whether the merged firm's actions would be sufficient to prevent or lessen competition substantially.

11.7 In the case of vertical mergers, the Bureau looks at four main categories of foreclosure:

- total input foreclosure, which occurs when the merged firm refuses to supply an input to rival manufacturers that compete with it in the downstream market;
- partial input foreclosure, which occurs when the merged firm increases the price it charges to supply an input to rival manufacturers that compete with it in the downstream market;[53]

52 For example, a vertical merger may allow the merged firm to remove or "internalize" existing double marginalization, since there is no longer any need for a mark-up on goods from the upstream firm to its downstream merger partner. With conglomerate mergers, the merged firm may be able to internalize the positive effect of a decrease in the price of one complementary product on the sales of another complementary product. This in turn may increase the output of both products, which is, all other things being equal, pro-competitive.

53 Foreclosure may also be accomplished through non-price means. For example, a merged firm may adopt product standards that are incompatible with those used by rivals, thus requiring rivals to invest in new standards in order to continue to purchase the merged firm's product or making it impossible for rivals to use

- total customer foreclosure, which occurs when the merged firm refuses to purchase inputs from an upstream rival; and
- partial customer foreclosure, which occurs when the merged firm is a distributor and can disadvantage upstream rivals in the distribution/resale of their products.

11.8 In the case of a conglomerate merger, the Bureau considers whether the combination of products in related markets will confer upon the merged firm the ability and incentive to leverage a strong market position from one market to another by means of tying products together. For example, the merged firm may harm its rivals by refusing to sell one product to customers unless customers also buy a second product from it. Assuming that rivals do not sell the same range of products as the merged firm, such tying may foreclose rivals by reducing their ability to compete, thereby preventing or lessening competition substantially.

Coordinated Effects of Non-Horizontal Mergers

11.9 The Bureau also considers whether a non-horizontal merger increases the likelihood of coordinated interaction among firms:

- A merger that leads to a high degree of vertical integration between an upstream market and a downstream retail market, or increases the degree of existing vertical integration, can facilitate coordinated behaviour by firms in the upstream market by making it easier to monitor the prices rivals charge upstream. Vertical mergers could also facilitate coordinated behaviour by firms in a downstream market by increasing transparency (by enabling firms to observe increased purchases of inputs) or by providing additional ways to discourage or punish deviations (by limiting the supply of inputs).
- A conglomerate merger may facilitate coordination by increasing the degree of multi-market exposure among firms (see paragraph 6.33, above).

PART 12: THE EFFICIENCY EXCEPTION

Overview

12.1 Section 96 of the Act provides an efficiency exception to the provisions of section 92. When a merger creates, maintains or enhances market power, section 96(1) creates a trade-off framework in which efficiency gains that are likely to be brought about by a merger are evaluated against the anti-competitive effects that are likely to result. It should be noted that the Bureau's approach is to expeditiously identify those few transactions that may raise material competition concerns and provide quick clearance for remaining transactions to provide commercial certainty and allow parties to achieve any efficiencies as quickly as possible. Consistent with that approach, a thorough assessment of efficiency claims is unnecessary in the vast majority of the Bureau's merger reviews.

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the merged firm's product altogether.

12.2 As the starting point, when determining the relevant anti-competitive effects for the purpose of performing the trade-off, the Bureau recognizes the significance of all of the objectives set out in the statutory purpose clause contained in section 1.1 of the Act.

12.3 The Bureau, in appropriate cases and when provided in a timely manner with the parties' evidence substantiating their case, makes an assessment of whether the efficiency gains that are likely to be brought about by a merger will be greater than and will offset the anti-competitive effects arising from that merger, and will not necessarily resort to the Tribunal for adjudication of the issue. However, the parties must be able to validate efficiency claims to allow the Bureau to ascertain the nature, magnitude, likelihood and timeliness of the asserted gains, and to credit (or not) the basis on which the claims are being made.

12.4 In general, categories of efficiencies that are relevant to the trade-off analysis in merger review include the following:

- allocative efficiency: the degree to which resources available to society are allocated to their most valuable use;
- technical (productive) efficiency: the creation of a given volume of output at the lowest possible resource cost; and
- dynamic efficiency: the optimal introduction of new products and production processes over time.

12.5 These categories are examined in reference to both gains in efficiency and anti-competitive effects (which include losses in efficiency).

12.6 For the purpose of the trade-off analysis in litigated proceedings before the Tribunal, the Bureau must show the anti-competitive effects of a merger. As outlined in more detail in paragraph 12.13 below, the merging parties must show all other aspects of the trade-off, including the nature, magnitude, likelihood and timeliness of efficiency gains, and whether such gains are greater than and offset the anti-competitive effects. Whether or not a case proceeds to litigation, the Bureau seeks information from the merging parties and other sources to evaluate gains in efficiencies and anti-competitive effects.

12.7 By incorporating an explicit exception for efficiency gains, Parliament has indicated that the assessment of the competitive effects of the merger under section 92 of the Act is to be segregated from the evaluation of efficiency gains under section 96. That said, cost savings from substantiated efficiency gains may be relevant to the analysis under section 92 of whether the merger is likely to prevent or lessen competition substantially in the following limited sense: the Bureau considers whether, as a result of true cost savings (discussed below under "Types of Efficiencies Generally Included in the Trade-Off"), the parties to the merger are better positioned to compete in a competitive market or are less likely to engage in coordinated behaviour.[54]

12.8 Where efficiencies may be material, merging parties are encouraged to make their efficiency submissions to the Bureau as early as possible in the merger review process. This facilitates an expeditious assessment of the nature, magnitude, likelihood and timeliness of the efficiency gains and of the trade-off between relevant efficiency gains and anti-competitive effects. Having detailed information regarding efficiency claims at an early stage of the process will facilitate the preparation of focused follow-up information requests and/or the targeted use of other information-gathering mechanisms and, subject to confidentiality restrictions, enable the Bureau to test the claims during its market contacts regarding the merger. Submissions regarding anticipated efficiency gains may also assist the Bureau in understanding the rationale underlying the proposed transaction.

Gains in Efficiency

12.9 To be considered under section 96(1), it must be demonstrated that the efficiency gains "would not likely be attained if the order (before the Tribunal) were made." This involves considering the nature of potential orders that may be made, including those that may apply to the merger in its entirety or are limited to parts of the merger. Each of the anticipated efficiency gains is then assessed to determine whether these gains would likely be attained by alternative means if the potential orders are made. Where the order sought is limited to parts of a merger, efficiency gains that are not affected by the order are not included in the trade-off analysis.

12.10 To facilitate the Bureau's review of efficiency claims, parties should provide detailed and comprehensive information that substantiates the precise nature, magnitude, likelihood and timeliness of their alleged efficiency gains, as well as information relating to deductions from gains in efficiency, such as the costs associated with implementing the merger. The information should specifically address the likelihood that such gains would be achieved and why those gains would not likely be achieved if the potential Tribunal orders were made.

12.11 Typically, the Bureau uses industry experts to assist in its evaluation of efficiency claims. To assess efficiency claims, Bureau officers and economists, as well as experts retained by the Bureau, require access to detailed financial and other information.[55] To enable the objective verification of anticipated efficiency gains, efficiency claims should be substantiated by documentation prepared in the ordinary course of business, wherever possible. This includes plant and firm-level accounting statements, internal

54 The impact of efficiencies on a firm's cost structure may render coordination more difficult by enhancing its incentive to compete more vigorously.

55 This includes all pre-existing merger planning documents. Additional information that may be relevant includes (1) information on efficiencies realized from previous mergers involving similar assets; (2) pre-merger documents relating to product and process innovation; and (3) information related to economies of scale, including minimum efficient scale, and economies of scope in production.

studies, strategic plans, integration plans, management consultant studies and other available data. The Bureau may also require physical access to certain facilities and will likely require documents and information from operations-level personnel who can address, among other matters, how their business is currently run and areas where efficiencies would likely be realized.

12.12 Section 96(2) requires the Tribunal to consider whether the merger is likely to bring about gains in efficiency described in section 96(1) that will result in (1) a significant increase in the real value of exports; or (2) a significant substitution of domestic products for imported products. To assist this analysis, firms operating in markets that involve international trade should provide the Bureau with information that establishes that the merger will lead them to increase output owing to greater exports or import substitution.[56]

Burden on the Parties

12.13 The parties' burden includes proving that the gains in efficiency

- are likely to occur. In other words, the parties must provide a detailed explanation of how the merger or proposed merger would allow the merged firm to achieve the gains in efficiency. In doing so, the parties must specify the steps they anticipate taking to achieve the gains in efficiency, the risks involved in achieving these gains and the time and costs required to achieve them.
- are brought about by the merger or proposed merger (i.e., that they are merger-specific). The test under section 96(1) is whether the efficiency gains would likely be realized in the absence of the merger. Thus, if certain gains in efficiency would likely be achieved absent the merger, those gains are not counted for the purposes of the trade-off.
- are greater than and offset the anti-competitive effects. The parties must provide a quantification of the gains in efficiency and a detailed and robust explanation of how the quantification was calculated. They should also, to the extent relevant, provide any information on qualitative efficiencies. While the burden is ultimately on the parties to establish that the gains in efficiency are greater than and offset the anti-competitive effects, in appropriate cases and when provided in a timely manner with the parties' evidence substantiating their case, the Bureau undertakes its own internal assessment of the trade-off before deciding whether to challenge a merger at the Tribunal.
- would not likely be attained if an order under section 92 were made. Gains in efficiency that would likely be achieved, even if an order prohibiting all or part of the merger were made, are not counted for the purposes of section 96.[57]

56 Increased output in this context is generally only possible with an associated decrease in price.

57 For example, if remedying a substantial prevention or lessening of competition required divestitures only in certain markets, cost savings resulting from the rationalization of head office facilities would not be included in the trade-off, assuming that such savings would be achievable despite the divestitures. A portion of head office cost savings may be relevant in this example only if the parties can clearly demonstrate that those cost savings

Types of Efficiencies Generally Included in the Trade-Off: Gains in Productive Efficiency

12.14 Productive efficiencies result from real cost savings in resources, which permit firms to produce more output or better quality output from the same amount of input. In many cases, such efficiencies can be quantifiably measured, objectively ascertained, and supported by engineering, accounting or other data, subject to a discount, as appropriate, for likelihood in practice. Timing differences in the realization of these savings are accounted for by discounting to the present value.

12.15 Productive efficiencies include the following:

- cost savings at the product, plant and multi-plant levels;
- savings associated with integrating new activities within the firm;[58] and
- savings arising from transferring superior production techniques and know-how from one of the merging parties to the other.[59]

12.16 Information respecting gains in efficiency that relate to cost savings should be broken down according to whether they are one-time savings or a recurring savings. When considering cost savings, the Bureau examines claims related to the following:

- economies of scale: savings that arise from product- and plant-level reductions in the average unit cost of a product through increased production;
- economies of scope: savings that arise when the cost of producing more than one product at a given level of output is reduced by producing the products together rather than separately;
- economies of density: savings that arise from more intensive use of a given network infrastructure;
- savings that flow from specialization, the elimination of duplication, reduced downtime, a smaller base of spare parts, smaller inventory requirements and the avoidance of capital expenditures that would otherwise have been required;
- savings that arise from plant specialization, the rationalization of various administrative and management functions (e.g., sales, marketing, accounting, purchasing, finance, production), and the rationalization of research and development activities; and
- savings that relate to distribution, advertising and raising capital.

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would not be achievable if the proposed remedy is granted. Only those gains in efficiency that will be forgone as a result of the remedy will be counted.

58 These include reduced transaction costs associated with contracting for inputs, distribution and services that were previously performed by third parties, but exclude pecuniary savings such as those related to bringing idle equipment into use if such idle capacity will be transferred from the merged firm to third parties.

59 While such legitimate production-related savings may exist, it will generally be difficult to demonstrate that efficiencies will arise owing to "superior management," that savings are specifically attributable to management performance or that they would not likely be sought and attained through alternative means.

Types of Efficiencies Generally Included in the Trade-Off: Gains in Dynamic Efficiency

12.17 The Bureau also examines claims that the merger has or is likely to result in gains in dynamic efficiency, including those attained through the optimal introduction of new products, the development of more efficient productive processes, and the improvement of product quality and service. When possible, the assessment of dynamic efficiencies is conducted on a quantitative basis. This is generally the case if there is information presented by the parties to suggest that a decrease in production costs as a result of an innovation in production technology or an increase in demand for the parties' products as a result of product innovation (leading to a new or improved product) is likely. To supplement quantitative information or where quantitative information is absent, the Bureau conducts a qualitative assessment.

12.18 The specific environment of the industry in question is important in the Bureau's analysis of the competitive effects of a merger on innovation. In light of the complexities and uncertainties associated with the assessment of dynamic efficiency claims, irrespective of the industry, certain types of industry information (in addition to that considered in paragraphs 12.10 and 12.11, above) can be particularly beneficial to the Bureau's assessment of a merger's impact on innovation as they relate to, for example, verifiability, likelihood of success and timeliness. Historical information on the effect of previous mergers in the industry on innovation may be insightful.[60] Such information may relate to a merger's impact on the nature and scope of research and development activities, innovation successes relating to new or existing products or production processes, and the enhancement of dynamic competition.[61] In addition, and only when applicable, the Bureau encourages parties to provide detailed explanations regarding plans to utilize substitute or complementary technologies so as to increase innovation.

Types of Efficiencies Generally Included in the Trade-Off: Deductions to Gains

12.19 Once all efficiency claims have been valued, the costs of retooling and other costs that must be incurred to achieve efficiency gains are deducted from the total value of the efficiency gains that are considered pursuant to section 96(1). Integrating two complex, ongoing operations with different organizational cultures can be a costly undertaking and ultimately may be unsuccessful. Integration costs are deducted from the efficiency gains.[62]

Types of Efficiencies Generally Excluded from the Trade-Off

12.20 Not all efficiency claims qualify for the trade-off analysis. The Bureau excludes the following:

60 Such information may be useful even when previous mergers did not necessarily involve any of the merging parties, since Bureau staff will examine the effect of past industry mergers on innovation through various sources of information, including industry experts and interviews with competitors.

61 In this context, dynamic competition refers to competition based on the successive introduction of new or better products over time.

62 Losses in dynamic efficiency described in paragraph 12.31, below, may also be deducted from gains in efficiency at this stage of the analysis, provided they are not double-counted.

- gains that would likely be attained in any event through alternative means if the potential orders were made (examples include internal growth, a merger with a third party,[63] a joint venture, a specialization agreement, and a licensing, lease or other contractual arrangement);[64]
- gains that would not be affected by an order, when the order sought is limited to part of a merger;
- gains that are redistributive in nature, as provided in section 96(3) of the Act (examples include gains anticipated to arise from increased bargaining leverage that enables the merging parties to extract wage concessions or discounts from suppliers that are not cost-justified, and tax-related gains);[65]
- gains that are achieved outside Canada (examples include productive efficiency gains arising from the rationalization of the parties' facilities located outside Canada that do not benefit the Canadian economy);[66] and
- savings resulting from a reduction in output, service, quality or product choice.

Anti-Competitive Effects

12.21 Section 96(1) requires efficiency gains to be evaluated against "the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger." The effects to be considered are not limited to resource allocation effects and include all the anti-competitive effects that are likely to arise from a merger, having regard to all of the objectives of the Act. Determination of the relevant anti-competitive effects depends upon the particular circumstances of the merger in question and the markets affected by the merger.

12.22 The Bureau examines all relevant price and non-price effects, including negative effects on allocative, productive and dynamic efficiency; redistributive effects; and effects on service, quality and product choice.

12.23 In addition to direct effects in the relevant market, the Bureau also considers price and non-price effects in interrelated markets. For example, mergers that are likely to

63 Consideration will only be given to alternative merger proposals that could reasonably be considered practical given the business realities faced by the merging firms.

64 The market realities of the industry in question will be considered in determining whether particular efficiencies could reasonably be expected to be achieved through non-merger alternatives. This includes growth prospects for the market in question, the extent of excess capacity in the market, and the extent to which the expansion can be carried out in increments.

65 Discounts from a supplier resulting from larger orders that would enable the supplier to achieve economies of scale, reduced transaction costs or other savings may qualify, to the extent that the savings by the supplier can be substantiated. Mere redistribution of income from the supplier to the merged firm in the form of volume or other discounts is not an efficiency.

66 A rationalization of the parties' facilities located outside of Canada where it could be established that these efficiencies would likely result in lower prices in Canada is an example of how such gains in efficiency from non-Canadian sources could accrue to the Canadian economy. The issue is whether the efficiency gains will benefit the Canadian economy rather than the nationality of ownership of the company.

result in increased prices and lower output can impair industries that use the merged firm's products as inputs.

12.24 Some examples of potential anti-competitive effects that can result from a merger are described below. This list is not intended to be exhaustive. While, in some cases, the negative impacts of a merger may be difficult to measure, all of the relevant anti-competitive effects of a merger are considered for the purposes of the trade-off. When anti-competitive effects (such as redistributive effects and non-price effects) cannot be quantified, they are considered from a qualitative perspective.

Price Effects: Loss of Allocative Efficiency (Deadweight Loss)

12.25 A merger that results in a price increase generally brings about a negative resource allocation effect (referred to as "deadweight loss"), which is a reduction in total consumer and producer surplus within Canada. This reflects a loss of allocative efficiency that is contrary to promoting the efficiency and adaptability of the Canadian economy.

12.26 In view of the difficulties associated with estimating the magnitude of a material price increase that is likely to be brought about by a merger and other variables, various estimates of the deadweight loss are usually prepared over a range of price increases and market demand elasticities.

12.27 The estimate of deadweight loss generally includes the following:

- losses to consumer surplus resulting from reductions in output owing to the merger;
- losses in producer surplus that arise when market power is being exercised in the relevant market prior to the merger[67]; and
- losses to consumer and producer surplus anticipated to result in interrelated markets.[68]

Price Effects: Redistributive Effects

12.28 Price increases resulting from an anti-competitive merger cause a redistributive effect ("wealth transfer") from buyers to sellers. Providing buyers with competitive prices and product choices is an objective of the Act.

Non-Price Effects: Reduction in Service, Quality, Choice

12.29 A substantial prevention or lessening of competition resulting from a merger can have a negative impact on service, quality, product choice and other dimensions of

67 When pre-merger conditions are not competitive, the deadweight loss arising from a merger may be significantly understated if this loss to producer surplus is not taken into account.

68 For example, when the products produced by the merged firm include intermediate goods that are used as inputs in other products, price increases in the intermediate goods can contribute to allocative inefficiency in interrelated markets.

competition that buyers value. Considering these effects is consistent with ensuring that buyers are provided with competitive prices and product choices.

Non-Price Effects: Loss of Productive Efficiency

12.30 Mergers that prevent or lessen competition substantially can also reduce productive efficiency, as resources are dissipated through x-inefficiency[69] and other distortions.[70] For instance, x-inefficiency may arise when firms, particularly in monopoly or near monopoly markets, are insulated from competitive market pressure to exert maximum efforts to be efficient.

Non-Price Effects: Loss of Dynamic Efficiency

12.31 Mergers that result in a highly concentrated market may reduce the rate of innovation, technological change and the dissemination of new technologies with a resulting opportunity loss of economic surplus.[71]

The Trade-Off

12.32 To satisfy the section 96 trade-off, the efficiency gains must both "be greater than and offset" the relevant anti-competitive effects.

12.33 The "greater than" aspect of the test requires that the efficiency gains be more extensive or of a larger magnitude than the anti-competitive effects. The "offset" aspect requires that efficiency gains compensate for the anti-competitive effects. The additional requirement to "offset" makes it clear that it is not sufficient for parties to show that efficiency gains merely, marginally or numerically exceed the anti-competitive effects to satisfy the section 96 trade-off. How significant this additional requirement may be has yet to be tested by the Tribunal and the courts.

12.34 Both the efficiency gains and the anti-competitive effects can have quantitative (measured) and qualitative aspects to them, and both the "greater than" and "offset" standards apply to all anti-competitive effects. To enable appropriate comparisons to be made, timing differences between measured future anticipated efficiency gains and measured anti-competitive effects are addressed by discounting to the present value.

12.35 Merging parties intending to invoke the efficiencies exception are encouraged to address how they propose that qualitative and quantitative gains and effects be evaluated for the purpose of performing the "greater than and offset" aspect of the

69 "X-inefficiency" typically refers to the difference between the maximum (or theoretical) productive efficiency achievable by a firm and actual productive efficiency attained.

70 For example, increased market power can lead to rent-seeking behaviour (such as lobbying) which can cause real economic resources to be consumed in activities directed towards redistributing income, rather than used in producing real output.

71 Losses in dynamic efficiency may be considered under anti-competitive effects or may be deducted from gains in efficiency at the outset, as indicated in paragraph 12.20.

trade-off; and to explain how and why the gains "compensate for" the anti-competitive effects.[72]

PART 13: FAILING FIRMS AND EXITING ASSETS

Business Failure and Exiting Assets

13.1 Among the factors that are relevant to an analysis of a merger and its effects on competition, section 93(*b*) lists "whether the business, or a part of the business, of a party to the merger or proposed merger has failed or is likely to fail." The opening clause of section 93 makes it clear that this information is to be considered "in determining, for the purpose of section 92, whether or not a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially." The impact that a firm's exit can have in terms of matters other than competition is generally beyond the scope of the assessment contemplated by section 93(*b*).

13.2 Probable business failure does not provide a defence for a merger that is likely to prevent or lessen competition substantially. Rather, the loss of the actual or future competitive influence of a failing firm is not attributed to the merger if imminent failure is probable and, in the absence of a merger, the assets of the firm are likely to exit the relevant market. Merging parties intending to invoke the failing firm rationale are encouraged to make their submissions in this regard as early as possible.

13.3 A firm is considered to be failing if:

- it is insolvent or is likely to become insolvent;[73]
- it has initiated or is likely to initiate voluntary bankruptcy proceedings; or
- it has been, or is likely to be, petitioned into bankruptcy or receivership.

13.4 In assessing the extent to which a firm is likely to fail, the Bureau typically seeks the following information:

- the most recent, audited, financial statements, including notes and qualifications in the auditor's report;
- projected cash flows;
- whether any of the firm's loans have been called, or further loans/line of credit advances at viable rates have been denied and are unobtainable elsewhere;
- whether suppliers have curtailed or eliminated trade credit;

72 The burden is ultimately on the parties to undertake the entire trade-off analysis and establish that the gains in efficiency are greater than and offset the anti-competitive effects.

73 Technical insolvency occurs when liabilities exceed the realizable value of assets, or when a firm is unable to pay its liabilities as they come due.

- whether there have been persistent operating losses or a serious decline in net worth or in the firm's assets;[74]
- whether such losses have been accompanied by an erosion of the firm's relative position in the market;
- the extent to which the firm engages in "off-balance-sheet" financing (such as leasing);
- whether the value of publicly-traded debt of the firm has significantly dropped;
- whether the firm is unlikely to be able to successfully reorganize pursuant to Canadian or foreign bankruptcy legislation, the Companies' Creditors Arrangement Act, or through a voluntary arrangement with its creditors.

13.5 These considerations are equally applicable to failure-related claims concerning a division or a wholly-owned subsidiary of a larger enterprise. However, in assessing submissions relating to the failure of a division or subsidiary, particular attention is paid to transfer pricing within the larger enterprise, intra-corporate cost allocations, management fees, royalty fees, and other matters that may be relevant in this context. The value of such payments or charges is generally assessed in relation to the value of equivalent arm's-length transactions.

13.6 Matters addressed in financial statements are ordinarily considered to be objectively verified when these statements have been audited or prepared by a person who is independent of the firm that is alleging failure. The Bureau's assessment of financial information includes a review of historic, current and projected income statements and balance sheets. The reasonableness of the assumptions underlying financial projections is also reviewed in light of historic results, current business conditions and the performance of other businesses in the industry.

Alternatives to the Merger

13.7 Before concluding that a merger involving a failing firm or division is not likely to result in a substantial lessening or prevention of competition, the Bureau assesses whether any of the following alternatives to the merger exist and are likely to result in a materially greater level of competition than if the proposed merger proceeds.

Acquisition by a Competitively Preferable Purchaser

13.8 The Bureau assesses whether there exists a third party whose purchase of the failing firm, division or productive assets is likely to result in a materially higher level of competition in the market.[75] In addition, such a third party ("competitively preferable purchaser") must be willing to pay a price which, net of the costs associated with

74 Persistent operating losses may not be indicative of failure, particularly in a "start-up" situation, in which such losses may be normal and indeed anticipated.

75 The Bureau considers whether the third party is capable of exercising a meaningful influence in the market. When an alternative buyer does not intend to keep the failing firm's assets in the relevant market, the Bureau assesses the extent to which the market power arising from the original merger proposal is likely to be less than if the alternative merger proceeds.

making the sale,[76] would be greater than the proceeds that would flow from liquidation, less the costs associated with such liquidation (referred to as the "net price above liquidation value").[77] Where it is determined that a competitively preferable purchaser exists, it can generally be expected that, if the proposed merger under review cannot be completed, the target will either seek to merge with that competitively preferable purchaser, or remain in the market. If the Bureau is not satisfied that a thorough search for a competitively preferable purchaser has been conducted, the Bureau will require the involvement of an independent third party (such as an investment dealer, trustee or broker who has no material interest in either of the merging parties or the proposal in question) to conduct such a search before the failing firm rationale is accepted.

Retrenchment/Restructuring

13.9 Where it appears that the firm is likely to remain in the market rather than sell to a competitively preferable purchaser or liquidate, it is necessary to determine whether this alternative to the proposed merger is likely to result in a materially greater level of competition than if the proposed merger proceeds. The retrenchment or restructuring of a failing firm may prevent failure and enable it to survive as a meaningful competitor by narrowing the scope of its operations, for instance, by downsizing or withdrawing from the sale of certain products or from certain geographic areas.

Liquidation

13.10 Where the Bureau is able to confirm that there are no competitively preferable purchasers for the failing firm and that there are no feasible and likely retrenchment scenarios, it assesses whether liquidation of the firm is likely to result in a materially higher level of competition in the market than if the merger in question proceeds. In some cases, liquidation can facilitate entry into a market by enabling actual or potential competitors to compete for the failing firm's customers or assets to a greater degree than if the failing firm merged with the proposed acquirer.

76 These costs include matters such as ongoing environmental liabilities, tax liabilities, commissions relating to the sale and severance and other labour-related costs.

77 Liquidation value is defined as the sale price of assets as a result of bankruptcy or foreclosure proceedings.

HOW TO CONTACT THE COMPETITION BUREAU

Anyone wishing to obtain additional information about the *Competition Act*, the *Consumer Packaging and Labelling Act* (except as it relates to food), the *Textile Labelling Act*, the *Precious Metals Marking Act* or the program of written opinions, or to file a complaint under any of these acts should contact the Competition Bureau's Information Centre:

Web site

www.competitionbureau.gc.ca

Address

Information Centre
Competition Bureau
50 Victoria Street
Gatineau, Quebec K1A 0C9

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