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THE RELEVANCE OF THE STRUCTURE-CONDUCT-PERFORMANCE PARADIGM TO HORIZONTAL MERGER ANALYSIS UNDER THE COMPETITION ACT

by

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A thesis submitted to the Faculty of Graduate Studies and Research in partial fulfillment of the requirements for the degree of Master of Laws

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JULY 1991

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ISBN 0-315-72123-5

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ABSTRACT

The merger provisions of the Competition Act proclaimed in force on June 19, 1986 are similar in several respects with section 7 of the Clayton Act and the decisions of U.S. Courts in antitrust merger cases. In the U.S. and Canada a merger may be enjoined only if it is likely to lessen competition substantially. Subsection 92(2) and section 93 of the Competition Act supply a list of factors that may be used in the assessment of the probable impact on competition that a merger could have. In the thesis the author discusses the meaning of subsection 92(2) of the Competition Act and the relevance of the "structure-conduct-performance paradigm" to horizontal merger analysis in the Canadian context.

In order to circumscribe the scope of subsection 92(2) the author proceeds to a comparative analysis of the U.S. and Canadian antitrust regimes. The meaning of subsection 92(2) remains unsettled since the Competition Tribunal has not yet made a decision on the merits in a contested merger. The interpretation of subsection 92(2) suggested hereinafter differs from that of the Director of Investigation and Research (Bureau of Competition Policy) and most antitrust commentators in Canada. It is hoped that it will help to stimulate debate around a major issue in horizontal merger analysis.

RÉSUMÉ

Les dispositions sur les fusionnements de la Loi sur la concurrence, entrées en vigueur le 19 juin 1986, ressemblent à plusieurs égards aux décisions des tribunaux américains ayant tranché la légalité de fusions horizontales en vertu du Clayton Act (section 7). Aux États-Unis et au Canada, une fusion peut faire l'objet d'une ordonnance uniquement si elle risque de diminuer sensiblement la concurrence. Le paragraphe 92(2) et l'article 93 de la Loi sur la concurrence énumèrent des facteurs qui peuvent être utilisés pour déterminer si un fusionnement pourrait vraisemblablement avoir des effets anticoncurrentiels. L'auteur dans son mémoire propose une interprétation du paragraphe 92(2) de la Loi sur la concurrence et se prononce sur l'application du "structure-conduct-performance paradigm" dans le cadre de l'examen des fusions horizontales au Canada.

Pour circonscrire la portée du paragraphe 92(2) l'auteur procède à une étude comparative de la législation sur la concurrence en vigueur aux États-Unis et au Canada. À ce jour, le Tribunal de la concurrence n'a pas rendu une seule décision portant sur l'interprétation du paragraphe 92(2) de la Loi sur la concurrence. L'interprétation de cette disposition mise de l'avant dans le mémoire diffère complète-

ment de celle du Directeur des enquêtes et recherches (Bureau de la politique de la concurrence) et de plusieurs experts canadiens en organisation industrielle. L'auteur espère que ses commentaires contribueront à susciter la discussion sur l'importance des parts de marché et de la concentration dans l'examen des fusions horizontales au Canada.

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INTRODUCTION

This is a thesis on a very specific element of the merger provisions embodied in the Competition Act. In the next pages we submit that market shares and index or ratio of concentration are the two most important factors for evaluating whether a horizontal merger is likely to lessen competition substantially. More specifically we contend that subsection 92(2) of the Competition Act, which stipulates that a finding of substantial lessening on competition cannot be based solely on evidence pertaining to market share and concentration, is not a negation of the structure-conduct-performance paradigm.

In the same perspective we submit that subsection 92(2) of the Competition Act does not preclude a prima facie finding of substantial lessening of competition, based on market share and index or ratio of concentration, as in the rule articulated by the U.S. Supreme Court in U.S. v. Philadelphia National Bank. We also contend that such an approach is not inconsistent with a multi-factor analysis of the likely anticompetitive effect of a horizontal merger, for countervailing evidence (e.g. low entry barriers, one party being a failing firm, efficiencies) is admissible to indicate that a merger is not likely to lessen competition substantially in spite of the fact that it would increase concentration and confer a large market share to the merging firm.

In the first part of the thesis we discuss the relevance of market share and concentration in analysing the antitrust implications of horizontal mergers. In this part there are three topics: a definition of the structure-conduct-performance paradigm; a review of the decisions of the U.S. Supreme Court having construed the Celler-Kefauver Act; and a general description of the merger guidelines issued by the U.S. Department of Justice in 1968 and 1982. In the second part we undertake an overview of the merger provisions of the Competition Act. Then we explain why these provisions as a whole tend to support our contention that subsection 92(2) of the Competition Act was not enacted for the purpose of rejecting the analytical approach adopted by the U.S. Supreme Court in Philadelphia National Bank.

It is important to mention that we do not address issues related to the definition of the relevant market, entry barriers and efficiencies. These elements are integral parts of the merger review process under the Competition Act. As will be discussed briefly they can influence significantly the outcome of an enquiry into the prospective anticompetitive effects of a horizontal merger. However, the exclusion of these issues does not affect our conclusions as to the meaning of subsection 92(2) of the Competition Act.

I. THE STRUCTURE-CONDUCT-PERFORMANCE PARADIGM

In this chapter we will concentrate on the analytical framework developed by the U.S. Supreme Court in the sixties and the seventies for analysing horizontal mergers under section 7 of the Clayton Act. This chapter is divided into four parts:

(i) A general description of the structure-conduct-performance paradigm.

(ii) An analysis of the more important decisions of the U.S. Supreme Court dealing with horizontal mergers.

(iii) A comparative analysis of the merger guidelines adopted by the U.S. Justice Department in 1968 and 1982.

(iv) Commentaries of antitrust analysts.

1.1 Structure-Conduct-Performance Paradigm: Definition

The structure-conduct-performance paradigm originates in part in empirical research performed by Joe S. Bain, an economist from the University of California at Berkeley[1]. Bain proceeded to an in-depth analysis of the organization of several industries in the United States in order to verify the exactitude of assumptions in price and general equilibrium theories. This led him to conclude that there is in fact a

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[1] Bain, Joe S., Industrial Organization (second edition), John Wiley and Sons Inc., New York (1968). The first edition was released in 1959.

direct relationship between market structure and the conduct of the industry in which companies operate. Bain's empirical analysis concerned the effect of concentration in an industry on competition. It was not an attempt to evaluate the implications of overall concentration in the economy. Thus the structure-conduct-performance model of analysis may be used only for the purpose of assessing the competitive impact of concentration in an industry.

The structure of a market is rarely either monopolistic or competitive. Hence, Bain devoted much attention to oligopoly. He identified three categories of oligopoly in the U.S. manufacturing sector based on the market share of the four and eight largest firms and the presence of a competitive fringe of smaller sellers. These three categories are: "very highly concentrated"; "highly concentrated" and "high-moderate concentration". Here are the characteristics of each category:

> An oligopoly with a very high level of concentration comprises three or four sellers controlling hundred per cent of the market.
>
> In an oligopoly with a high level of concentration the four largest firms control between 65 and 75% of the market, the eight largest between 85 and 90%. In addition, we find from 20 to 100 small sellers sharing the remaining slice of the market.
>
> An oligopoly exhibits a "high-moderated" level of concentration when the four largest firms control between 50 and 65% of the market, the largest eight between 70 and 85%. Furthermore, there is a fringe

of smaller competitors which play an important role in stimulating competition in the market[2].

The different types of market structures described previously are said to determine the conduct of the firms. It serves as an indicator of the intensity of interfirm rivalry in an industry. The structure of the market permits inferences to be drawn as to price and output decisions. More specifically it may be relied upon in order to ascertain whether such decisions are likely to be made independently or interdependently[3].

The behavior of firms within oligopoly industries was also investigated by Scherer[4] and Caves[5]. They agree with the basic assumption of Bain's studies that a small number of competitors holding collectively an important market share is more likely to enter into tacit or overt agreement on prices.

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[2] Bain, Joe S., supra, note 1, pp. 137-140.

[3] Bain affirms that in a "very highly concentrated" oligopoly "oligopolistic interdependence may be presumed to be at practical maximum"; in "highly concentrated oligopoly" it can be presumed to be "very strong"; and in a "high-moderate" concentrated oligopoly "it is still enough to produce a substantial degree of oligopolistic interdependence", supra, note 1, (pp. 137 and 140).

[4] Scherer, F.M., Industrial Market Structure and Economic Performance, Rand McNally College Publishing Company, 1980 (2 ed.).

[5] Caves, Richard, American Industry: Structure, conduct, performance (4th Ed. 1977).

The studies conducted by Scherer and Caves support the contention that the structure-conduct-performance paradigm is a valid scheme of analysis even if it fails to explain satisfactorily every aspect of oligopolistic firms' conduct. However, the paradigm has been criticized by some economists and lawyers practising in the field of antitrust law.

In the seventies some commentators took the position that the basic assumption underlying the structure-conduct-performance paradigm must be reconsidered in light of "new learning"[6]. In short these analysts contend that a high level of concentration within markets brings efficiency instead of market power, conscious parallelism and poor performance. Supporters of the new learning postulate that large market share held by oligopolistic firms are needed in order to achieve economies of scale. They also make the argument that oligopoly theories suggesting that there is a correlation between a high level of concentration and a decrease in interfirm rivalry are unsound because firms are profit-maximizers. Robert H. Bork is the leading advocate of this trend in antitrust analysis[7]. More recently there was an

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[6] Goldschmid, Mann, Weston, Industrial Concentration: The New Learning, Little, Brown and Company (1974).

[7] Bork, Robert H., The Antitrust Paradox, Basic Books, New York (1978).

attempt to explain the conduct of firms in the market with reference to factors external and internal to the enterprise[8].

In summary the structure-conduct-performance paradigm posits that a high level of market concentration increases significantly the likelihood of departure from competitive conduct. This in turn is likely to lead to unsatisfactory performance, i.e. higher than competitive prices and output restriction. This economic model was formally incorporated in the analysis of the legality of horizontal mergers under section 7 of the Clayton Act by the U.S. Supreme Court in U.S. v. Philadelphia National Bank.

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[8] Brenner, Reuven, Rivalry, Cambridge University Press (1987); Williamson, Oliver E., Markets and Hierarchies, Free Press, 1983 Edition.

1.2 Mergers and Acquisitions[9]: Need for Regulation

The basic issue at the center of the antitrust review process respecting horizontal mergers is whether, in a specific case, firms should expand internally or externally. The tension between internal and external growth reflects divergent views as to the proper role of regulatory agencies in reviewing mergers and acquisitions. The role of regulators in this field may be viewed as either interventionist or non-interventionist. The interventionist approach is based on the assumption that the government has a duty to monitor transactions in the market in order to prevent modifications to market structure prone to engender anticompetitive behavior

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[9] The eighties was a decade of intense activity in the field of mergers and acquisitions in Canada:

YEAR	NUMBER OF MERGERS*
1980	414
1981	491
1982	576
1983	628
1984	641
1985	712
1986	938
1987	1,082
1988	1,053
1989	1,091

* Including foreign and domestic mergers.

(Source: Bureau Merger Register. Annual Report for the year ended March 31, 1990; Director of Investigation and Research, Competition Act, C.C.A. Canada).

and, ultimately, poor economic performance[10]. On the other hand, the non-interventionist approach posits that mergers and acquisitions are the expression of market forces at work. Thus regulators should not intervene in a process that yields efficiency[11].

A merger may have procompetitive virtues. This is the case when two firms merge to achieve the minimum scale of efficiency. Yet mergers may have a detrimental impact on the level of competition prevailing within an industry. Horizontal, vertical and conglomerate mergers have different features; hence their likely effect on competition is assessed under distinctive standards. A priori horizontal mergers raise more concerns with antitrust laws than vertical and conglomerate mergers. However, this is not to suggest that the latter may never have a negative impact on competition[12].

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[10] Bain, Joe S., Industrial Organization, Wiley and Son Inc., New York (2 ed.) (1968).

[11] Bork, Robert H., The Antitrust Paradox, Basic Books Inc., New York (1978).

[12] On March 8, 1979 Senator Edward M. Kennedy introduced the "Small and Independent Business Protection Act of 1979" before the U.S. Senate Committee on the Judiciary. The Small and Independent Business Protection Act was designed to apply to mergers and consolidations as well as asset and stock acquisitions. Every transaction between two firms having each more than two billion dollars worth in assets or sales would have been per se illegal. A transaction involving two firms with assets or sales over 350 million dollars, or alternatively one firm with assets or sales over 350 million dollars and another with a market share of 20% or more, would have been unlawful unless the parties could invoke

The same is true of joint ventures. Usually, joint ventures are for a limited period of time and motivated because of the limited resources of the parties. Yet, joint ventures can be used by rivals in order to achieve anticompetitive

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successfully specific means of defence.

The bill was providing for two separate defences. The parties could establish either that the transaction would have "the preponderant effect of substantially enhancing competition" or "result in substantial efficiencies". The word efficiency, as defined in the bill, meant economies of scale. The defence of efficiencies was available to demonstrate that the merger would improve the productivity of the merging firm in manufacturing, marketing, distribution and research and development. In short, every firm with assets or sales over 350 million dollars up to 2 billion dollars wishing to merge with a firm of similar size would have had the burden to demonstrate either type of efficiencies.

There was also a provision available to merging parties unable to establish the kind of efficiencies described in the previous paragraph. An acquisition would have been allowed to proceed if the parties had "divested one or more viable business units". Such divestiture would have had to occur in the year immediately preceding or following the consummation of the transaction. There was a specification as to the viable business unit to be divested. It had to be of a specific size, i.e. with assets and revenues equal to or greater than those of the smaller party to the transaction.

(U.S. Senate, Committee on the Judiciary, Subcommittee on Antitrust, Monopoly and Business Rights; Hearings on Mergers and Economic Concentration, 96th Congress, First Session, March 8, 1979).

objectives[13]. The G.M.-Toyota joint venture in the automobile industry is a good example[14].

Amalgamation of two competitors can transform permanently the structure of an industry since it is almost never possible to restore the prior structure once a merger is completed. If a merger provides the parties with market power it means that the structure of the industry could remain monopolistic, especially if there are entry barriers. A merger may also facilitate illegal anticompetitive conduct. For instance, a merger can, under certain circumstances, enable the merging firm to engage in predatory pricing, i.e. "pricing below an appropriate measure of cost for the purpose of eliminating competitors in the short run and reducing competition in the long run"[15]. As will be discussed in more detail in a

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[13] Pitofsky, Robert, "Joint Venture Under the Antitrust Laws: Some Reflections on the Significance of Penn-Olin", 82 Harvard Law Review 1007 (1969); Brodley, Joseph F., "Joint Ventures and Antitrust Policy", 95 Harvard Law Review 1521; U.S. v. Penn-Olin Chemicals Co. et al., 387 U.S. 158; Brunswick Corp., 94 F.T.C. 1174; Yamaha Motor Corp. v. F.T.C., 657 F. 2d 971; F.T.C. v. Warner Communication, 742 F. 2d 1156; U.S. v. Ivaco Inc., 704 F. Supp. 1409.

[14] See Appendix A of the thesis. For discussion see Brodley, Joseph F., "The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress", 62 N.Y.U.L.R. 1020 (1987).

[15] Cargill Inc. v. Monfort of Colorado Inc., 107 S. Ct. 484 (1986), at p. 493. See also paragraph 50(1)(c) of the Competition Act and cases: R. v. Hoffman Laroche Ltd., 125 D.L.R. (3d) 607; R. v. Consumers Glass Co. Ltd. et al., 57 C.P.R. (2d) 1; R. v. The Producers Dairy Ltd., 50 C.P.R. (2d) 265.

following section, another possible consequence of a merger is the "oligopolization" of the market structure of an industry. When concentration in a market is high a merger can increase interdependency among leading firms and result in parallel behavior. Conscious parallelism is a pricing policy adopted by leading firms in a concentrated industry that recognizes their interdependence and amounts to non-price competition.

U.S. antitrust laws are more effective than Canadian antitrust laws at sanctioning collusive agreements among competitors. In the United States price fixing is per se illegal under section 1 of the U.S. Sherman Act[16]. This means that it is only necessary to prove that defendants entered into an agreement for fixing prices which affects interstate commerce[17]. Then there is no need to inquire as to whether the price restraint is reasonable. Besides, pure conscious parallelism as defined in the previous paragraph may fall under the monopoly offence embodied in section 2 of the U.S. Sherman Act[18].

In Canada section 45 of the Competition Act prohibits price fixing only to the extent prices are enhanced

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[16] U.S. v. Socony-Vacuum Oil Co., 310 U.S. 150, reaffirmed by Arizona v. Maricopa County Medical Society, 457 U.S. 332.

[17] U.S. v. Socony-Vacuum Oil Co., 310 U.S. 150.

[18] American Tobacco Co. v. U.S., 328 U.S. 781.

In Canada section 45 of the Competition Act prohibits price fixing only to the extent prices are enhanced "unreasonably"[19] or competition is lessened "unduly"[20]. The Court of Appeal of the Province of Québec ruled recently that certain agreements could be per se illegal under section 45 of the Competition Act[21]. Yet, in the majority of cases courts are compelled to undertake an inquiry in order to assess the impact of a price-fixing agreement[22]. Although a specific subsection was added to section 45 in 1986 providing that a conspiry may be established via circumstantial evidence, it remains uncertain whether pure conscious parallelism could be

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[19] Competition Act, R.S.C. 1985, c. C-34 as amended by R.S.C. 1985, 2nd Supplement, c. 19, paragraph 45(1)b).

[20] Competition Act, supra, paragraph 45(1)c).

[21] Pavillon Chasse et Pêche (440) Inc. v. Sumner Sports Inc., [1990] R.J.Q. 1863, at 1871:

> "La rigueur de l'article 1 du Sherman Act permet aux tribunaux américains de juger illégales, à leur face même, certaines conventions à partir de leur seule rédaction. Mais, sauf ces cas relativement exceptionnels, on s'en remettra à une "rule of reason" à partir des faits de l'espèce. Chez nous, en revanche, l'expression "indûment" à l'article 32 de la loi ne permet pas qu'on s'en tienne au seul texte de la convention pour la déclarer en soi illégale, quoiqu'une preuve bien sommaire puisse parfois suffire. Je n'aurais ainsi, pour ma part, aucune difficulté à juger "illegal per se" une convention très restrictive dès qu'on aurait prouvé qu'elle regroupe tous les producteurs et distributeurs d'une denrée de base. Mais encore faudrait-il un minimum de preuve au-delà du texte de la convention reprochée".

[22] Atlantic Sugar v. Attorney General of Canada, [1980] 2 S.C.R. 644; Aetna Insurance v. The Queen, [1978] 1 S.C.R. 731.

enforced under that section[23]. Perhaps this type of anti-competitive conduct may constitute an abuse of dominant position pursuant to subsection 79(1) of the Competition Act. The constitutionality of section 45 is currently contested by corporate defendants charged with price-fixing inter alia on the ground that the word unduly is void for vagueness under the Canadian Charter of Rights and Freedom[24].

Shared monopolies were a preoccupation to the U.S. Government in the sixties. In December 1967 former U.S. President Lyndon B. Johnson mandated a special task force to elaborate an antitrust policy. The Task Force was chaired by Phil C. Neal (then Dean of the Law School of the University of Chicago) and composed inter alia of William F. Baxter and Robert H. Bork. In a report made public in 1969 the White House Task Force on Antitrust Policy recommended drastic

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[23] Competition Act, supra, note 19, subsection 45(2.1).

[24] The Superior Court of the Province of Quebec and the Supreme Court of Nova Scotia ruled that section 45 is inconsistent with the Charter (L'Association québécoise des pharmaciens propriétaires et al. c. Le Procureur général du Canada et al., [1991] R.J.Q. 205; R. v. Nova Scotia Pharmaceutical Society, 32 C.P.R. (3d) 259). The decision of the Supreme Court of Nova Scotia was reversed on appeal: The Queen v. N.S. Pharmaceutical Society (S.C.C. 02368 unreported, April 24, 1991). This matter will likely be decided eventually by the Supreme Court of Canada.

measures aimed at maintaining competitive market structure and to encourage competitive conduct[25].

To translate economic policy in the field of mergers and acquisitions into statutory rules is no easy task. These statutory rules must be enforceable and predictable. In the United States Congress adopted a valuable antitrust statute which has been constructed in a very pragmatic way by the U.S. Supreme Court. The U.S. experience with respect to the enforcement of their antitrust merger law deserves that we pay attention to it because it represents a useful model for both regulators and the judiciary.

1.3 The U.S. Supreme Court and the Celler-Kefauver Act of 1950

In 1914 Congress enacted the Federal Trade Commission Act[26] and the Clayton Act[27]. This legislation, inter alia, aimed at preventing anticompetitive mergers by conferring to the Federal Trade Commission jurisdiction to review mergers

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[25] Report of the White House Task Force on Antitrust Policy, 2 Antitrust Law and Economic Review, 1968-69, p. 11. Also in 1974, Senator Phillip S. Hart proposed the adoption of the Industrial Reorganization Act (reprinted in Appendix B of Goldschmid, Mann, Weston, "Industrial Concentration: The New Learning", supra, note 6). See Appendix B of the thesis.

[26] 38 Stat. 717; 52 Stat. 111; 15 U.S.C. 41.

[27] 38 Stat. 730; 15 U.S.C. 12.

and acquisitions and providing for injunctive relief to private plaintiffs. Originally, section 7 of the Clayton Act was very limited in scope, applying only to stock acquisitions. Soon it became clear that section 7 was hardly enforceable; it was very easy to avoid the application of the law simply by acquiring assets. This had been confirmed by a decision rendered by the U.S. Supreme Court in F.T.C. v. Western Meat Co.[28].

Thus, in 1950 Congress enacted the Celler-Kefauver Act. This statute was an amendment to section 7 of the Clayton Act making this section applicable to stock and asset acquisitions[29]. Between 1950 and 1960 the U.S. Supreme Court had not had an opportunity to interpret the newly drafted section 7 of the Clayton Act. So, in 1960 Derek C. Bok, an Assistant Professor of Law at Harvard University, proposed an analysis

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[28] 272 U.S. 554. See also Arrow-Hart and Hegeman v. F.T.C., 291 U.S. 587.

[29] The relevant part of section 7 reads:

> "Sec. 7. That no corporation engaged in commerce shall acquire, directly or indirectly the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."

of section 7 of the Clayton Act relying on legal and economic concepts[30].

In essence, he argued that in analysing the antitrust implications of horizontal mergers we should be guided by the increase in concentration produced by the merger and the resulting market share of the merging firm. Furthermore, he claimed that the parties should have the opportunity to introduce evidence showing that the target firm was failing. Bok favoured such a pragmatic approach because he was of the opinion that it is useless to conduct an exhaustive review of all relevant economic data in assessing the impact of a horizontal merger on competition.

According to Bok the futility of considering a whole range of economic factors stems from the fact that theoretical studies and empirical research performed by economists do not allow courts to predict the likely anticompetitive consequences of most mergers. Yet, we can assume that a merger modifying substantially market structure warrants antitrust action even if nobody can predict accurately to what extent an increase in market concentration may contribute to a lessening of competition. Bok concluded that a structural approach with

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[30] Bok, Derek C., "Section 7 of the Clayton Act and the Merging of Law and Economics", 74 Harvard Law Review 226 (1960).

respect to horizontal mergers is required for reasons of predictability. He pointed out that enforcement and policy considerations also dictate a structural approach given the institutional limit of the judiciary.

On June 15, 1962 the U.S. Supreme Court issued its first decision dealing with section 7 of the Clayton Act as amended by the Celler-Kefauver Act. In Brown Shoe Co. Inc. v. U.S.[31] the Court had to decide the legality, under section 7 of the Clayton Act, of a transaction whereby Brown Shoe Co. Inc. had acquired the stocks of G.R. Kinney Company Inc. In the Brown Shoe case, Chief Justice Warren delivered an important judgment concerning the guidelines to be applied in the interpretation of section 7 of the Clayton Act, the definition of the relevant market (i.e. "product" and "geographic" markets) and the factors that must be considered in evaluating whether a merger may lessen competition substantially.

Brown Shoe and Kinney were both manufacturers and retailers of men's, women's and children's shoes. They ranked respectively third and eighth among the largest retailers of shoes in the U.S.; and fourth and twelfth among the largest manufacturers of shoes in the U.S. Kinney was also operating the most important chain of shoe stores in the U.S.. The

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[31] 370 U.S. 294.

merger raised antitrust issues at the horizontal and vertical levels: horizontally there were concerns that the merger could lessen competition at the manufacturing and retailing stages; vertically the issue was whether the acquisition by an important manufacturer of the largest retail chain of shoes would foreclose an important segment of the market.

Before discussing the merits of the case, the Court considered the legislative history of section 7 of the Clayton Act. Reference to the legislative history was necessary in order to find the intent of the legislature. Chief Justice Warren remarked that the major objective of Congress in adopting the Celler-Kefauver Act was to prevent increased economic concentration in the U.S. economy and to preserve a decentralized economic system composed of small enterprises. He identified eight guidelines for the purpose of circumscribing the scope of the Celler-Kefauver Act, namely that Congress sought to:

- bring asset acquisitions under the coverage of section 7 of the Clayton Act;
- encompass horizontal, vertical and conglomerate mergers under section 7 of the Clayton Act;
- provide regulatory agencies and private plaintiffs with an opportunity to prevent mergers and acquisitions that would increase concentration before they are completed;
- make clear that section 7 of the Clayton Act does not require the same burden of proof as in cases of Sherman Act violations;

. make possible for parties to complete a merger that may have competitive benefits, i.e. protect competition not competitors;

. make sure that the impact of a merger would be assessed under quantitative and qualitative factors;

. subject mergers to an analytical framework that takes into consideration the characteristics of the industry within which it takes place;

. provide a test for evaluating the probable anticompetitive effects of a merger[32].

To decide the legality of the merger previously described, the Court relied on several factors. It defined the relevant market as every city exceeding 10,000 (including suburban area) where Brown and Kinney retailed men's, women's and children's shoes via their respective outlets. The combined market share of Brown and Kinney in the selected cities, in the year prior to the merger, ranged from 5.1 to 57.7% for women shoes, 5 to 51.8% for children shoes and 5.1 to 24.8% for men shoes. The majority of the Court emphasized the predominance of the market share factor in deciding the legality of a merger pursuant to section 7 of the Clayton Act[33].

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[32] Brown Shoe, supra, pp. 337 and 339.

[33] Brown Shoe, supra, at p. 343: "The market share which companies may control by merging is one of the most important factors to be considered when determining the probable effects of the combination on effective competition in the relevant market".

In addition to market shares and concentration the Court referred to other factors like the trend toward concentration in the industry, the financial situation of the parties and the need to protect small business. The Court also pointed out that the merger was not a means to achieve economies of scale whereby the competitiveness of the new entity would be improved. In summary, the U.S. Supreme Court used a range of factors in assessing the legality of the Brown-Kinney merger but emphasized that market share factor.

One year later, the U.S. Supreme Court in U.S. v. Philadelphia National Bank[34] articulated a more focussed analytical framework to be applied by the Courts in litigation involving the legality of a horizontal merger under section 7 of the U.S. Clayton Act. Philadelphia National Bank is a landmark case, for the principles enunciated therein are the cornerstone of the methodology that has been used by the judiciary since in reviewing horizontal mergers[35]. This is the most important decision rendered by the U.S. Supreme Court as to the merger aspect of antitrust laws since the enactment of the Celler-Kefauver Act in 1950.

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[34] 374 U.S. 321.

[35] See Appendix C of the thesis.

In Philadelphia National Bank the Court went one step further beyond Brown Shoe by adopting an explicit structural approach toward horizontal mergers. It ruled that a merger between two competing firms conferring to the new entity an unduly large market share and increasing significantly the level of concentration in the market is, prima facie, likely to lessen competition substantially[36]. Therefore, the Court acknowledged that market shares and concentration ratios may be paramount, even determinative, under certain circumstances.

In the Philadelphia National Bank case the majority relied on legal precedents and economic theory in formulating the prima facie rule based on concentration ratios and market shares. In two previous cases the Court had decided the legality of an exclusive dealing agreement and of a vertical merger by evaluating the importance of the market segment

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[36] U.S. v. Philadelphia National Bank, 374 U.S. 321, at p. 363:

> "This intense congressional concern with the trend toward concentration warrants dispensing, in certain cases, with elaborate proof of market structure, market behavior, or probable anticompetitive effects. Specifically, we think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects."

foreclosed[37]. Such a test was deemed to be "fully consonant with economic theory"[38], i.e. the structure-conduct-performance paradigm establishing a relation between the number of competitors and the level of competition in a market. Accordingly, the Court expressed the view that section 7 of the Clayton Act is the expression of an economic philosophy favouring corporation growth through internal expansion rather than through consolidation with competitors.

The majority of the Court opted for a structural approach for two reasons. First, it considered this approach convenient given the need to provide predictability in enforcement. It is necessary for regulatees to be able to anticipate the reaction of regulators, i.e. whether regulators would be opposed to a specific transaction. Second, a structural test was considered to be required by "the interest of sound and practical judicial administration"[39]. Given the limited resources of the judiciary, courts should avoid endless economic investigation in the case of a horizontal merger which transforms significantly market structure.

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[37] U.S. v. E.I. du Pont de Nemours, 353 U.S. 586; Standard Oil Company v. U.S., 337 U.S. 393.

[38] U.S. v. Philadelphia National Bank, 374 U.S. 321, p. 363.

[39] Philadelphia National Bank, supra, note 36, p. 362.

Concentration ratios and market shares are reliable enough for inferences to be drawn from them.

The merger of Philadelphia National Bank and Girard Trust Corn Exchange Bank was reviewed pursuant to the principles just enumerated. Philadelphia National Bank and Girard Trust were respectively the second and the third largest commercial banks in the Philadelphia metropolitan area. Once the merger was completed, the merging firms would have had a 30% market share; the two largest banks in the area would have had 59% of the market; and the four largest banks in the area would have had 78% of the market. In this case the market shares involved were more considerable than those in Brown Shoe.

The Court had no hesitation in ruling that a merger conferring control over 30% of the market and increasing concentration by 33% - thereby raising the four-firm concentration ratio to 78% - should be declared prima facie unlawful under section 7 of the Clayton Act. However, the Court did not intend to fix a rigid threshold based on a 30% market share. It made clear that a lesser market share could also trigger the application of the prima facie rule[40]. Otherwise

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[40] U.S. v. Philadelphia National Bank, 374 U.S. 321, at pp. 364-65, note 41:

> "Needless to say, the fact that a merger results in a less-than-30% market share, or in a less substantial increase in concentration than in the instant case, does

the enforcement of a fixed threshold could engender unjust results.

The Court did not consider only economic data pertaining to concentration ratios and market shares. It decided that the merger contravened section 7 of the Clayton Act because defendants had not reversed the presumption established by the economic data just mentioned. At the outset, it was emphasized that Philadelphia National Bank and Girard Trust growth was due in part to mergers and acquisitions; in addition, there was a noticeable trend toward concentration in the Philadelphia metropolitan area commercial banking market.

The evidence relating to concentration ratios and market shares was weighted against evidence as to entry barriers, economies and the financial situation of the parties. Entry barriers were important since regulatory approval was required to enter the market. Nor was the merger essential to realize economies of scale or any other type of efficiency prone to improve competitiveness – the banks were the second and the third largest in the market. Finally, neither Philadelphia National Bank nor Girard Trust was a failing firm so the failing firm defence had no application.

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not raise an inference that the merger is not violative of section 7."

In two subsequent cases the U.S. Supreme Court seems to have departed from the principles enunciated in Philadelphia National Bank. In Philadelphia National Bank, the Court had limited the applicability of the prima facie rule of illegality specifically "to mergers whose size makes them inherently suspect in light of Congress' design in section 7 to prevent undue concentration"[41]. Yet, in two subsequent decisions, the same tribunal declared two mergers unlawful pursuant to section 7 of the Clayton Act even if the market shares of the companies involved were small.

In U.S. v. Von's Grocery Co.[42], it was decided that the government had proved that the merger of Von's Grocery Company and Shopping Bag Food Stores would lessen competition substantially in the retail grocery market in the Los Angeles metropolitan area. The decision was based on limited evidence. The record showed that Von's Grocery and Shopping Bag Food were the third and sixth largest retail grocery stores in the L.A. metropolitan area. The merger made them the second largest retailer with a combined market share of 7.5%.

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[41] U.S. v. Philadelphia National Bank, 374 U.S. 321, at 363.

[42] 384 U.S. 270.

The Court relied almost exclusively on the prevailing trend toward concentration in the market in deciding that the merger was illegal. It referred to the history of the Sherman, Clayton, and Celler-Kefauver Acts to explain why the merger should be opposed. The Court explained that historically, monopoly and economic concentration have been suspicious; that this suspicion led in 1950 to the enactment of the Celler-Kefauver Act — whose legislative history indicates that its purpose was to prevent economic concentration and to preserve decentralized industrial organizations.

Unquestionably there was a trend toward concentration in the retail grocery stores market within the Los Angeles metropolitan area. This trend had provoked a decrease in the number of independent owners of grocery stores in the same area. Small independent groceries were acquired by grocery chains before and after the merger thereby contributing to concentration in ownership of grocery stores. Hence the Court took the position that it had to break the momentum toward concentration in the market.

Subsidiarily the Court discussed the financial and competitive situations of the parties. The merger was not contemplated in order to avoid failure of the target firm or to realize efficiencies. In that respect, Mr. Justice Black

noted that the two companies were "two highly successful, expanding and aggressive competitors[43]. Furthermore, he pointed out that a combined market share of 7.5% could possibly raise no antitrust problem in a market where there is no trend toward concentration[44].

Almost at the same time the U.S. Supreme Court issued another decision concerning the legality of a horizontal merger under section 7 of the Clayton Act. In U.S. v. Pabst Brewing Co.[45] the government litigated the merger of two brewers, i.e. Pabst Brewing Company and Blatz Brewing Company – the tenth and eighteenth largest brewers in the U.S. The Justice Department complained that the merger was likely to lessen competition substantially in the production and sale of beer in three geographic markets. It was alleged that competition could be hurt nationwide and in an interstate region composed of Michigan, Illinois and Wisconsin and generally statewide in Wisconsin.

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[43] U.S. v. Von's Grocery Co., 384 U.S. 270, at 272.

[44] Ibid., p. 278: "If ever such a merger would violate section 7, certainly it does when it takes place in a market characterized by a long and continuous trend toward fewer and fewer owner-competitors which is exactly the sort of trend which Congress, with power to do so, declared must be arrested".

[45] 384 U.S. 546 (1965).

After the merger, the merging firm had become the fifth largest brewer in the U.S. with a 4.49% market share. It controlled 11.32% of the market in the interstate area described previously and 23.95% of the market across the state of Wisconsin. Although the market share in Wisconsin was important, the market shares in the interstate area and in the U.S. were not. In spite of that, the merger was held to transgress section 7 of the Clayton Act for virtually the same reasons as in the Von's Grocery case discussed priorly.

The Court observed a pattern of concentration in the beer industry similar to the one it had found to exist in the Los Angeles metropolitan area grocery market. The number of brewers was diminishing and the largest among them were controlling more and more of the beer market. There is no reference in the decision to mitigating factors such as low entry barriers, possible economies to be realized or the financial condition of the parties. Also of importance is the statement of Mr. Justice Black to the effect that it is irrelevant whether the trend toward concentration in an industry is a consequence of mergers or consolidations[46]. In Pabst Brewing, the U.S. Supreme Court came very close to

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[46] U.S. v. Pabst Brewing Co., 384 U.S. 546, at 552-53: "We hold that a trend toward concentration in an industry whatever its causes, is a highly relevant factor in deciding how substantial the anticompetitive effect of a merger may be".

establishing a per se rule of illegality for horizontal mergers based on market shares and concentration ratios when there is a trend toward concentration in an industry.

In the seventies the Burger Court reiterated the prima facie test of illegality elaborated in Philadelphia National Bank. For the first time the Court ruled in favour of defendants in a litigated horizontal merger case in spite of statistical evidence indicating that a merger was prima facie unlawful pursuant to section 7 of the Clayton Act. The decision of the U.S. Supreme Court in U.S. v. General Dynamics Corporation[47] clearly illustrates that the review process of horizontal mergers under section 7 of the Clayton Act consists in an evaluation of several factors. Such a ruling does not alter the fact that concentration ratios and market shares may indicate, prima facie, a contravention to section 7 of the Clayton Act.

In 1959, General Dynamics Corporation took over Material Service Corporation, an important producer and supplier of coal located in the midwest. Material Service had previously acquired 34% of the stocks of United Electric Coal Companies, another coal producer operating mines in Illinois and Kentucky. In 1966, General Dynamics acquired the remaining

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[47] 415 U.S. 486.

stock of United Electric Coal. One year later, the Department of Justice brought a civil action claiming that the stock acquisitions made by Material Service and General Dynamics in United Electric Coal violated section 7 of the Clayton Act. The government complained that the merger was likely to lessen competition substantially in the production and sale of coal within two possible geographic markets, i.e. the State of Illinois or the "Eastern Interior Coal Province Sales Areas", a multistate area comprising, inter alia, Illinois.

In General Dynamics the Court had to decide whether evidence as to the state of development of the coal industry and the competitive position of the target firm could be used to reverse a presumption of illegality based on concentration ratios and market shares. The issue was highly relevant for in Philadelphia National Bank it was mentioned that under certain circumstances a merger could be presumed to lessen competition substantially "in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects[48]".

Like in the previous cases the Court noted that there was a trend toward concentration in the coal industry. In 1959, when Material Service took control of United Electric the

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[48] Philadelphia National Bank, supra, note 36.

four-firm concentration ratio was 54.5% in the Illinois market and 43% in the Eastern Province area. In 1967, when United Electric became a wholly-owned subsidiary of General Dynamics the ratio was 75.2% and 62.9% within the same geographic markets. In 1959, the merger had conferred upon Material and United market shares of 23.2% in the Illinois market and 12.4% in the Eastern Province area. In 1967, the market shares were 21.8% and 10.9% respectively.

Mr. Justice Stewart affirmed explicitly that the government had demonstrated, prima facie, that the two stock acquisitions were likely to lessen competition substantially. He then analysed countervailing evidence presented by the parties to the transaction before the trial court. The evidence introduced by defendants to rebut the presumption consisted in an analysis of the pattern of supply and demand in the coal industry. This approach is somewhat different from those already mentioned (e.g. entry barriers, economies and failing firm).

In the decades prior to the transaction, significant changes had occurred in the coal industry. The majority put emphasis on three of them. The importance of coal as a source of energy had declined progressively throughout the 20th century mainly as a consequence of emergence of substitutes in the market. This in turn had affected demand for coal in the

market; by the end of the sixties, 59% of coal production in the U.S. was purchased by electric utilities. Usually electric utilities purchased important quantities of coal through long-term supply agreements. The Court had to assess the impact of the merger on present and future competition in the coal industry. Because the vast majority of coal produced was purchased by utilities, coal producers were primarily competing to supply utilities under long-term supply contracts. Hence, in order to evaluate the competitiveness of the target firm the Court relied on the firm's uncommitted coal reserves instead of past production. United Electric Coal reserves were limited and depleting; this factor was affecting considerably its ability to compete in the future and was decisive in the Court finding's that defendant had reversed the prima facie case of illegality made by the government[49].

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[49] U.S. v. General Dynamics Corp., 415 U.S. 486, at 501:

"Because of these fundamental changes in the structure of the market for coal, the District Court was justified in viewing the statistics relied on by the Government as insufficient to sustain its case. Evidence of past production does not as a matter of logic, necessarily give a proper picture of a company's future ability to compete. In most situations, of course, the unstated assumption is that a company that has maintained a certain share of a market in the recent past will be in a position to do so in the immediate future. Thus, companies that have controlled sufficiently large shares of a concentrated market are barred from merger by section 7, not because of their past acts but because their past performances imply an ability to continue to dominate with at least equal vigor."

The conclusion that United Electric Coal could not be an efficient competitor in the future was not based on the failing-firm defence. Indeed, the Trial Court had found that it was a "highly profitable and efficient producer". Rather the Court relied on one ruling in Brown Shoe to the effect that a merger must be analysed in light of the particular context of the industry in which the merging firms operate. It appears that in this case the whole context of the coal industry described previously was the determining factor in the same way as the trend toward concentration was in Von's Grocery and Pabst Brewing.

The decision of the U.S. Supreme Court in General Dynamics represents an adjustment, not a new trend in horizontal merger analysis. As mentioned before, in Brown Shoe the majority held that the legality of a merger under section 7 of the Clayton Act must be decided by taking into account several factors. It stressed that among all relevant factors market share and concentration are the most important. In Philadelphia National Bank, Mr. Justice Brennan emphasized that these two structural factors should not be considered on an equal basis with other elements. He stated that market share and concentration are the cornerstone of horizontal merger analysis. Thus additional factors are admissible to rebut the presumption that a high level of concentration and

a large market share created by a merger are likely to lessen competition substantially.

But in Von's Grocery and Pabst Brewing the Court found horizontal mergers to be in violation of antitrust laws even if the evidence consisted almost exclusively in an increase of concentration in the industry and in the market share of the parties. Moreover, the mergers involved had conferred to the merging firms small market shares. The Court's analysis seems to be inconsistent with the structure-conduct-performance paradigm. The inconsistency lies in the fact that in Von's Grocery and Pabst Brewing the number of competitors was not reduced substantially; hence, no important modification to the market structure had occurred. Accordingly, the risk that the remaining firms engage in anticompetitive conduct was low.

So when the U.S. Supreme Court has had to decide the legality of the merger in General Dynamics there was a certain confusion among the cases decided in the sixties after the enactment of the Celler-Kefauver Act. The Court seized the opportunity it had to reconcile these conflicting interpretations and to set down a clear test. It appears that the majority, by considering countervailing evidence submitted by defendants as to the competitive position of one party to the transaction, just swung the pendulum back to Philadelphia National Bank.

1.4 The Merger Guidelines Issued by the Department of Justice in 1968 and 1982

In 1968, the Department of Justice for the first time issued a whole set of merger guidelines[50]. The guidelines summarized the enforcement policy of the Antitrust Division toward mergers and acquisitions. The merger guidelines aimed at specifying under which circumstances a merger would be challenged by the Department of Justice. Although such guidelines are not "binding upon the courts"[51], they are very useful to the persons who plan a transaction. Guidelines as to mergers and acquisitions provide information essential not only to the business sector but also to the general public. They contribute to enhancing regulator's accountability by limiting discretion in the decision-making process.

The merger guidelines released in 1968 detailed the approach of the Department of Justice as to horizontal, vertical and conglomerate mergers. The guidelines also explained how regulators would define the relevant product and geographic markets in order to assess the impact on competition of each type of merger. Clearly, the 1968 merger guidelines adopted a structuralist approach to regulating

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[50] A version of the U.S. Department of Justice Merger Guidelines issued on May 30, 1968 is reprinted in the Antitrust Bulletin, Fall 1982 at 667.

[51] Marathon Oil Co. v. Mobil Corp., 669 F. 2d 378 (1981).

mergers and acquisitions. They reflected an explicit recognition of the structure-conduct-performance paradigm as an underlying economic theory for antitrust enforcement.

The section of the guidelines dealing with horizontal mergers was almost a codification of the decisions of the U.S. Supreme Court analysed in the previous section. Horizontal mergers were subject to a threefold analysis: identification of the relevant market; application of concentration ratios and market share thresholds; and consideration of countervailing factors. This is illustrative of the methodology used in Philadelphia National Bank where structural factors were relied on only to establish a prima facie case of illegality not a per se rule.

Markets were divided into three categories according to the importance of the four largest firms. A market with a four-firm concentration ratio of 75% or more was considered to be "highly concentrated"[52]; one with a four-firm concentration ratio inferior to 75% "less highly concentrated"[53]. The Antitrust Division was also concerned with markets "with a trend toward concentration"[54]. In a highly concentrated

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[52] Merger Guidelines of 1968, supra, note 50, at 672.

[53] Merger Guidelines of 1968, supra, note 50, at 672.

[54] Merger Guidelines of 1968, supra, note 50, at 672.

market the Justice Department warned that a horizontal merger would entail enforcement action if the market shares of the parties were:

Acquiring firm	Acquired firm
4%	4% or more
10%	2% or more
15% or more	1% or more

Similar action was expected from the Justice Department in markets less concentrated if the acquiring and the acquired firms had the following market shares:

Acquiring firm	Acquired firm
5%	5% or more
10%	4% or more
15%	3% or more
20%	2% or more
25%	1% or more

In addition, a market was deemed to be becoming increasingly concentrated if in a period between 5 and 10 years before the merger, the concentration ratio as measured by the market share of the largest firms had increased by 7% or more[55]. In all these situations, there was a presumption that the merger would lessen competition substantially in violation of section 7 of the Clayton Act.

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[55] Merger Guidelines of 1968, supra, note 50, at 672.

In spite of a substantial increase in concentration, a merger remained unchallenged if one of the parties was a failing company or if economies were expected. As to the failing firm defence, the Department of Justice applied the principles enunciated by the U.S. Supreme Court in International Shoe[56]. However, there was a reluctance to accept a defense based on economies, i.e. a merger likely to improve efficiency. Economies were recognized only in "exceptional circumstances" and the guidelines referred explicitly only to economies of scale[57].

On June 14, 1982, the Reagan administration repealed the 1968 merger guidelines and released radically new ones[58]. On that day, U.S. Attorney General William French Smith announced a new merger policy which assumed that generally mergers are innocuous from an antitrust standpoint. Unlike those issued in 1968 the merger guidelines of 1982 are inconsistent with the jurisprudence of the U.S. Supreme Court discussed previously. The general purpose of the 1982 merger guidelines

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[56] International Shoe Co. v. F.T.C., 280 U.S. 234.

[57] The Department's reluctance to accept a defense based on economies stemmed from three considerations: first, the guidelines were drafted so as to avoid a challenge to a merger made to achieve minimum scale of efficiency; second, economies can be achieved via internal growth; third, economies are almost impossible to assess accurately. Merger Guidelines of 1968, supra, note 50 at 674.

[58] U.S. Department of Justice Merger Guidelines, 47 Fed. Reg. 28,493 (June 30, 1982).

(as amended in 1984) is to prevent mergers that yield or increase market power. Significant changes were introduced as to the definition of the product and geographic market; also new standards were used for assessing market concentration in horizontal merger cases.

The product and geographic markets are defined by hypothesizing a five percent price increase. It is used to evaluate the cross-elasticity of demand for the product(s) of the parties to the merger and to identify their competitors. The relevant product market consists of a product or several products over which a theoretical monopolist could maintain a 5% price hike during one year[59]. Similarly, the relevant geographic market consists in all the firms which could collectively maintain a 5% price hike during one year[60]. Therefore, the relevant geographic market is the area where the merging firm and their competitors operate.

The four-firm concentration ratio is no longer used by the Department of Justice for measuring market concentration. Instead, it uses the "Herfindahl-Hirschman Index" which is the sum of the squares of the market shares of every firm in the

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[59] 1982 Merger Guidelines, supra, note 58, subsection II-A.

[60] 1982 Merger Guidelines, supra, note 58, subsection II-B.

market. The guidelines identify three types of markets: "unconcentrated", "moderately concentrated" and "highly concentrated". An H.H.I. below 1000 indicates an unconcentrated market; an H.H.I. between 1000 and 1800 indicates a moderately concentrated market; and an H.H.I. above 1800 indicates a highly concentrated market. Basically, the guidelines take into consideration the H.H.I. in the market before and after the merger. Horizontal mergers resulting in an H.H.I. below 1000 are unlikely to be challenged by the Department of Justice. If the H.H.I. is between 1000 and 1800 after the merger, it is likely to be litigated if it produces an increase in the H.H.I. of more than 100 points. In the case of a merger raising the H.H.I above 1800 it is very likely to be challenged if it produces an increase in the index of more than 100 points[61].

A specific provision applies to leading firms. The "leading firm proviso" provides that a merger between a firm with a market share of 35% or more and another with a market share of 1% or more is likely to be challenged by the Department of Justice. In that case, the market share of the leading firm must be twice the size of the second largest firm

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[61] Merger Guidelines (1982), supra, note 58, see Horizontal Mergers (section III) - Concentration and Market Share (subsection A).

in the market[62]. In addition to market share and index of concentration, the guidelines indicate that the Department of Justice will consider whether there are entry barriers in the industry[63]. It also assesses whether the merger would facilitate direct or tacit collusion among the remaining competitors within the market. Factors that may lead the Department to conclude that collusion would be easier are inter alia: the characteristic of the product of the firms (i.e. homogeneous or heterogeneous); past anticompetitive conduct in the industry; and performance of the firms in the market[64].

The guidelines mention two separate means of defence: the traditional failing firm exception and efficiencies[65]. The most important change is with regard to efficiencies since they are not perceived anymore with skepticism. They are now accepted as a legitimate goal to be achieved through mergers and acquisitions. The guidelines refer to "substantial cost savings" to be derived from scale economies, integration of

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[62] Merger Guidelines (1982), supra, note 58, paragraph III-A.2.

[63] 1982 Merger Guidelines, supra, note 58, paragraph III-B.

[64] 1982 Merger Guidelines, supra, note 58, paragraph III-C.

[65] 1982 Merger Guidelines, supra, note 58, subsection V-A.

production facilities or multi-plant operations[66]. Efficiencies are fully integrated to the merger review process in spite of the fact that they are "far easier to allege than to prove".

In June 1984, the Department of Justice clarified certain sections of the 1982 guidelines[67]. As to the market definition section it was specified that the hypothetical 5% price increase in most cases would be based on the prevailing price of the product at the time of the transaction. It was also emphasized that the price increase has to be adapted to the industry where a merger takes place and that it would be necessary in some cases to hypothesize a price increase of less or more than 5%[68]. The 1984 guidelines recognize that foreign competitors must be included and that the geographic market may have worldwide dimensions[69]. Furthermore, it is reiterated that the guidelines are predicated on a multi-factor approach, that the H.H.I. numbers are only thresholds

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[66] 1982 Merger Guidelines, supra, note 58, at p. 28,502.

[67] U.S. Department of Justice Merger Guidelines, 49 Fed. Reg. 26,823.

[68] 1984 Merger Guidelines, supra, note 67, subsection 2.11.

[69] 1984 Merger Guidelines, supra, note 67, subsection 2.34.

aimed at indicating mergers likely to raise antitrust concerns[70]. Finally, the range of efficiencies was expanded to include, inter alia, lower transportation costs and reductions in general selling, administrative and overhead costs[71].

The general thrust of the guidelines is perceived by many commentators and academics as an attempt to amend section 7 of the Clayton Act through the administrative process[72]. The merger guidelines issued by the Reagan administration contain a whole new set of rules concerning market definition and concentration which have influenced considerably the enforcement of section 7 of the Clayton Act by the Department of Justice throughout the eighties. However, market shares and indices of concentration remain the two most important

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[70] 1984 Merger Guidelines, supra, note 67, subsection 3.11.

[71] 1984 Merger Guidelines, supra, note 67, subsection 3.5.

[72] Adams and Brock, "Reaganomics and the Transmogrification of Merger Policy", Antitrust Bulletin (Summer 1988), p. 309; Krattenmaker and Pitofsky, "Antitrust Merger Policy and the Reagan Administration", Antitrust Bulletin (Summer 1988), p. 211; Schwartz, Louis B., "The New Merger Guidelines: Guide to Governmental Discretion and Private Counseling or Propaganda for Revision of the Antitrust Laws?", 71 California Law Review 575 (1983); Bauer, Joseph P., "Government Policy of Section 7 of the Clayton Act: Carte Blanche for Conglomerate Mergers?", 71 California Law Review 348 (1983).

factors in the assessment of the likely impact of a horizontal merger on competition[73].

The most virulent criticisms were directed against the section of the guidelines dealing with market definition. Harris and Jorde[74] complained that the Department of Justice defines the relevant market by wrongly assuming that antitrust laws are aimed at promoting efficiency only. In their view, the fact that regulators rely on such an assumption and use purely fictitious models for predicting future supply and demand patterns for defining the relevant market result in the market identified being overly large. They stress in their article that antitrust policy must be based on economic theories supported by empirical evidence as to the decision-making factors relied on by firms in the market.

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[73] Baker, Donald I., "The 1982 Guidelines and Preexisting Law", 71 California Law Review 311: "Quite clearly, the 1982 Guidelines retreat significantly from many populist merger landmarks of the Warren Court era, as well they should. (...) Nevertheless, the retreat is far from total. Horizontal mergers are still assessed under the basic methodology of U.S. v. Philadelphia National Bank, under which the court first defines a relevant market and then draws competitive inferences from market shares within it".

[74] Harris, Robert G. and Jorde, Thomas M., "Market Definition and the Merger Guidelines: Implications for Antitrust Enforcement", 71 California Law Review 464 (1983).

In a Note reproduced in the Yale Law Journal, Gene C. Schaerr[75] criticized the use of the prevailing price in the industry at the time of the merger (as opposed to the competitive price) in postulating a 5% price increase. According to Schaerr, by doing so the Department of Justice reproduces the "Cellophane Fallacy" which has the effect of reducing the market power of one or more firms. Hence, a merger between two firms with monopoly power looks more innocuous than a merger between two firms charging competitive prices. This is so because firms with market power charge supra-competitive prices, i.e. prices superior to those prevailing in a competitive market. The implementation of the 5% price increase test to a monopoly price contributes to enlarge the range of substitutes for the product of the merging firms which in turn extends the boundaries of the product market. Therefore, the pre- and the post-merger H.H.I. as well as the increase in the index appear less significant in the end. For all these reasons, Schaerr contends that the test provided for measuring the relevant market is inadequate for "preventing mergers that create, enhance or facilitate the exercise of market power"[76].

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[75] NOTE, "The Cellophane Fallacy and the Justice Department Guidelines for Horizontal Mergers", 94 Yale Law Joural 670 (1985).

[76] At p. 625 Schaerr notes:

> "Contrary to the Posner-Baxter view, a producer's ability to impose additional price increases upon

In a recent article, Robert Pitofsky charged the Reagan administration with having deliberately adopted new rules for defining the relevant market in order to overthrow antitrust enforcement under section 7 of the Clayton Act[77]. Pitofsky contends that the implementation of these rules underestimate any market power merging firms may have because, inter alia, the guidelines do not take into consideration return on investment for the purpose of assessing whether the parties price above the competitive level. As a result, the Department of Justice failed in litigating some anticompetitive mergers while it refused to challenge others that were prevented by the courts at the request of private plaintiffs[78].

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consumers is not the only factor that, as a matter of economic theory, ought to be considered in analyzing a horizontal merger under section 7. Although a merger between firms already charging a collusive, supra-competitive price might not permit an additional increase in price, such a merger might nonetheless "lessen competition" in violation of section 7 by giving the new firm an increased ability to sustain a supra-competitive price."

[77] Pitofsky, Robert, "New Definition of Relevant Market and the Assault on Antitrust", 90 Columbia Law Review 1805 (1990).

[78] Ibid., at pp. 1808-09:

"By modifying relevant market analysis so as to diminish the appearance of market power, these advocates seek to achieve a result that many of them have described candidly as their goal – the removal of antitrust enforcement as an impediment to all business transactions except outright cartels, mergers leading directly to monopoly power, and some unusual types of predatory conduct."

The Herfindhal-Hirschman Index was also discussed by some commentators. Calkins[79] is of the opinion that the use of the index and the thresholds incorporated in the guidelines may discourage vigorous enforcement against mergers by antitrust agencies. Don Turner proposed a different threshold for differentiating concentrated and unconcentrated markets. He would opt for a "single general market share test" based on an increase of 100 points in the H.H.I.[80]. The appropriateness of the H.H.I. numbers in the guideline was also questioned by a district judge in proceedings for the modification of a consent order[81].

The 1982 merger guidelines are a set of highly complex, not to say unenforceable, rules imposing an almost impossible task on regulators. In trying to predict with certainty the future consequences of a merger by relying on hypothetical factors the guidelines compel regulators to engage in never-ending analysis. However, the guidelines do not repudiate the analytical framework developed in Philadelphia National Bank for analysing horizontal mergers. Nevertheless, given the

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[79] Calkins, Stephens, "The New Merger Guidelines and the Herfindahl-Hirschman Index", 71 California Law Review 402 (1983).

[80] Turner, Donald F., "Observations on the New Merger Guidelines and the 1968 Merger Guidelines", 51 Antitrust Law Journal 307 (1982), p. 311.

[81] U.S. v. Loew's Incorporated et al., 705 F. Supp. 878, at p. 889 (1988).

rules applicable to the definition of the market, few mergers are likely to increase concentration so as to warrant intervention by the Department of Justice.

1.5 Summary

We have reviewed the most important decisions of the U.S. Supreme Court rendered in the sixties and the seventies regarding the interpretation of section 7 of the Clayton Act in horizontal merger cases. We also analysed the merger guidelines issued by the Department of Justice in 1968 and 1982. It appears that the decision of the U.S. Supreme Court in the matter of Philadelphia National Bank was a turning point in horizontal merger analysis.

Areeda and Turner endorse the prima facie rule of illegality enunciated in Philadelphia National Bank[82]. Like Bok they are of the opinion that concentration ratios and market shares remain the more reliable factors to assess the

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[82] Areeda, Phillip and Turner, Donald F., Antitrust Law, Little and Brown, Boston (1978), Volume 4, Section 9B, "Market Shares as a Presumptive Proof of Illegality". At p. 27 they summarize their position in these words:

> "Nevertheless, the needs of predictability for merging parties, efficient use of enforcement resources by the government, practical decisionmaking by courts and other tribunals, and the prophylactic purpose of the antimerger statute all dictate the use of market shares as at least the presumptive basis for deciding the legality of horizontal mergers."

impact that a merger is likely to have on competition. According to their own assessment they define a concentrated market as one exhibiting either a four-firm concentration ratio of more than 70% or a Herfindhal index of 1300 or more[83]. However, because concentration ratios and market shares have shortcomings they emphasize that these two factors should be relied on to establish a prima facie case of illegality only to the extent that defendants are allowed to introduce evidence questioning their accuracy (e.g. failing firm, efficiencies[84]).

Robert H. Bork is perhaps the most adamant critic of the Warren Court rulings under section 7 of the Clayton Act with respect to horizontal mergers. His views on antitrust are incorporated in a book he wrote in 1978 The Antitrust Paradox[85]. Basically, Bork claims that the interpretation of antitrust laws by the judiciary in the United States has been crippling economic efficiency. To him the only purpose of antitrust laws is to preserve and enhance consumer welfare. In order to achieve consumer welfare Bork contends that courts

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[83] Supra, note 82, at 29.

[84] Areeda, Phillip and Turner, Donald F., Antitrust Law, Little and Brown, Boston (1978). See Volume IV, "Economics as a Defense to Prima Facie Illegality".

[85] Bork, Robert H., The Antitrust Paradox, Basic Books (New York) 1978.

must interpret antitrust laws so as to favour economic efficiency.

Bork's antitrust theories are predicated on the assumption that automatically mergers are the result of efficiencies created by the proper functioning of market mechanism. He assumes that the invisible hand of the market always stimulates competition in the marketplace. Bork advocates a policy of tolerance toward mergers and consolidations unless they create a highly concentrated market structure, i.e. a market with less than three competitors[86]. If a merger does not alter significantly market structure as indicated the only motive behind it is the realization of efficiencies. Hence, Bork considers that firms must be allowed to decide by which route they wish expanding (i.e. either through merger or internal growth) because in most cases mergers are unlikely to result in output restriction.

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[86] More specifically at pp. 221-22 of the Antitrust Paradox (supra note 85), he suggests:

> "Competition in the sense of consumer welfare should be adequately protected and the mandate of Section 7 satisfactorily served if the statute were interpreted as making presumptively lawful all horizontal mergers up to market shares that would allow for other mergers of similar size in the industry and still leave three significant companies. In a fragmented market, this would indicte a maximum share attainable by merger of about 40 percent. In a market where one company already has more than 40 percent, the maximum would be scaled down accordingly."

In his book Bork criticizes vehemently three decisions of the U.S. Supreme Court, i.e. Brown Shoe, Von's Grocery and Pabst Brewing (supra). Because the market shares involved in these cases were insignificant, he says that the U.S. Supreme Court has established a per se rule of illegality for almost every horizontal merger. In his view, this approach is inconsistent with the purpose of section 7 of the Clayton Act (as amended by the Celler-Kefauver Act) and unsound from an economic standpoint. Yet Bork seems to be committed to a structural approach toward horizontal mergers for he proposes a presumptive rule of legality based on market share. Surprisingly Bork does not discuss Philadelphia National Bank. Indeed, there is not a single word on that decision in the Antitrust Paradox. Given the importance of the case as a precedent such an omission is difficult to explain.

Another proponent of the antitrust theories of the University of Chicago, Richard S. Posner, discussed the appropriateness of the analytical framework articulated by Mr. Justice Brennan in Philadelphia National Bank. Now a Circuit Judge, Mr. Justice Posner, has had an opportunity to review on appeal a decision of the Federal Trade Commission which held that the acquisition by Hospital Corporation of America of Hospital Affiliates International Inc. and Health

Care Corporation violated section 7 of the Clayton Act[87]. The U.S. Court of Appeals for the Seventh Circuit had to decide if the decision of the F.T.C. was based on substantial evidence on the record. The merger provided Hospital Corporation of America with control over three hospitals in the city of Chattanooga, Tennessee. Hospital Corporation of America was also bound by two management contracts of a duration of four years with two other hospitals. Before the merger Hospital Corporation had a 15% market share and the four-firm concentration ratio in the market was 79%. After the merger (by including the two hospitals under management contract) it had a market share of 26% and the four-firm concentration ratio had increased to 91%.

Mr. Justice Posner noted that Philadelpha National Bank is the only decision in which the U.S. Supreme Court "took an explicitly economic approach to the interpretation of the statute"[88]. He affirmed the decision of the F.T.C. which was

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[87] Hospital Corp. of America v. F.T.C., 807 F. 2d 1381 (1986). See also F.T.C. v. Elders Grain Inc., 868 F. 2d 901 (1989).

[88] Hospital Corp. of America v. F.T.C., 807 F. 2d 1381 (1986), p. 1385. At p. 1386 he emphasizes:

> "When an economic approach is taken in a section 7 case, the ultimate issue is whether the challenged acquisition is likely to facilitate collusion. In this perspective the acquisition of a competitor has no economic significance in itself; the worry is that it may enable the acquiring firm to cooperate (or cooperate better) with other leading competitors on reducing or limiting

based on an in-depth investigation of the likely impact of the merger on competition. The F.T.C. analysed several factors pertaining to the supply and demand of hospital services including cross-elasticity of demand, entry barriers, market share, concentration, past anticompetitive conduct, and cost pressures imposed by public and private insurers. Mr. Justice Posner implied that if the F.T.C. had based its decision solely on evidence showing that the merger had contributed to decrease significantly the number of important competitors in a market with regulatory entry barriers, thereby increasing the risk of cartelization or conscious parallelism, he would have maintained the decision of the F.T.C.[89].

We can fairly assert that since Philadelphia National Bank there has been a consensus in the United States that enforcement of section 7 of the Clayton Act against horizontal mergers requires the implementation of a presumptive test of illegality based on the level of concentration and market shares. This fact is illustrated by court decisions and the

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output, thereby pushing up the market price."

[89] Hospital Corporation of America v. F.T.C., 807 F. 2d 1381 (1986), at 1388:

> "In showing that the challenged acquisitions gave four firms control over an entire market so that they would have little reason to fear a competitive reaction if they raised prices above the competitive level, the Commission went far to justify this prediction of probable anti-competitive effects. Maybe it need have gone no further."

antitrust policy adopted by the Johnson, Nixon, Carter and even Reagan administrations. In the next section we will discuss the relevance of Philadelphia National Bank to the interpretation of the merger provisions of the Competititon Act.

II. THE MERGER PROVISIONS OF THE COMPETITION ACT

In Section I, we have described how the U.S. Supreme Court has incorporated the structure-conduct-performance paradigm into the legal analysis of horizontal mergers under section 7 of the Clayton Act. We will now analyse the merger provisions of the Competition Act in order to determine whether the prima facie rule of illegality of Philadelphia National Bank is applicable in the Canadian context. The whole analytical approach to mergers and acquisitions embodied in the Competition Act suggests that it was intended to apply a test like that elaborated in Philadelphia National Bank.

2.1 The Merger Provisions of the Competition Act

On June 19, 1986, the Competition Tribunal Act was proclaimed into force[90]. This legislation established a new specialized tribunal, i.e. the Competition Tribunal. At the same time several sections of the Combines Investigation Act were amended and the title was changed to the Competition Act[91]. Among other significant changes, two important

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[90] An Act to establish the Competition Tribunal and to amend the Combines Investigation Act and the Bank Act and other Acts in consequence thereof (1986 S.C. c. 26). Proclaimed into force on June 19, 1986 SI/86-109, July 9, 1986.

[91] Combines Investigation Act, R.S.C. 1985, c. C-34 as amended by R.S.C. 2nd Supplement, c. 19.

sections were added: a purpose clause (section 1.1) and a specific provision making the Competition Act applicable to commercial activities of Crown corporations engaged in "in competition, whether actual or potential, with other persons" (section 2.1).

Mergers and acquisitions are subject to a whole new set of statutory provisions. Subsection 92(2) of the Competition Act provides that remedial action be taken against a merger likely to lessen competition "substantially". This test was imported from section 7 of the U.S. Clayton Act[92]. Although there is no definition of the word substantially, section 91 supplies a definition of merger[93]. The definition of merger in section 91 is very wide. It encompasses both the acquisition of "control" and the acquisition of a "significant interest" in a "business". This may be achieved directly or indirectly, by one or several persons, through stock or asset acquisition, amalgamation or joint venture. It can consist in the acquisition of the business of a "competitor, supplier, customer or other person".

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[92] Supra, note 29.

[93] "91. In sections 92 to 100, "merger" means the acquisition or establishment, direct or indirect, by one or more persons, whether by purchase or lease of shares or assets, by amalgamation or by combination or otherwise, of control over or significant interest in the whole or a part of a business of a competitor, supplier, customer or other person."

The words control and business are defined in section 2 of the Competition Act[94]. One person acquires control over another if it holds securities conferring more than 50% of the voting rights and is able to elect the majority of the directors of the acquiree. However, there is no definition of the expression significant interest. This provision aims at covering the situation where the ownership of less than 50% of the voting shares of a publicly-held corporation provides the shareholder(s) with substantial control over its decision-making process[95].

The Competition Act specifically mentions factors that may be taken into consideration in the assessment of the likely impact of a merger on competition. These factors are: market share and concentration (subsection 92(2)); foreign competition (subsection 93a); the financial health of a party involved (subsection 93b)); cross-elasticity of demand for the product of the parties (subsection 93c)); entry barriers (subsection 93d)); remaining effective competition in the market after the merger (subsection 93e)); whether an

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[94] Subsection 2(1) "business"; subsection 2(4) "control".

[95] The Director of Investigation and Research considers that in most instances a participation in voting shares inferior to 10% is not a substantial interest. Acquisition of voting shares in the range of 10 or 50% are evaluated on a case by case basis (Source: MERGER ENFORCEMENT GUIDELINES; D.I.R. Consumer and Corporate Affairs Canada, Information Bulletin No. 5, March 1991, at pp. 1 and 2).

effective and vigorous competitor would be removed (subsection 93f)); change and innovation in the market (subsection 93g)); and all other relevant factors (subsection 93h)).

The merger provisions do not apply to bank mergers under certain circumstances (subsection 94b)). Joint ventures formed through a partnership to accomplish a specific operation or research and development are not subject to subsection 92(1) of the Competition Act. Instead, section 95 of the Act provides a distinct test for this type of transaction. The limitation period to challenge a merger under the Competition Act is three years (section 97). A merger cannot be contested under section 92 if the Attorney General of Canada has brought criminal proceedings under section 45 of the Competition Act or if the Director of Investigation and Research has filed an application for abuse of dominant position pertaining to the transaction (section 98).

The enforcement mechanism embodied in the Competition Act confers upon the Director of Investigation and Research the authorization to bring an application before the Competition Tribunal against a merger likely to lessen competition substantially. Private parties are not allowed to make an application to the Competition Tribunal nor are they entitled to make a claim for damages caused by a merger having anti-

competitive effects[96]. This reduces significantly the role that the Competition Tribunal and other courts could play in the enforcement of the merger provisions of the Competition Act.

In November 1989 the employees of Steinberg Inc. filed an action for a permanent injunction and a motion for an interlocutory injunction against Corporation d'acquisition Socanav-Caisse Inc. based on subsection 92(1) of the Competition Act. It was alleged in the declaration that the acquisition by CAS-Caisse Inc. of all shares of Steinberg Inc. was a merger likely to lessen competition substantially. The Union representing the employees of Steinberg sought an order enjoining to CAS-Caisse Inc. to dispose of all the shares acquired. Mr. Justice Phelan dismissed the action and the motion for an interlocutory injunction because the Competition Tribunal has jurisdiction to hear such matters. He stated that the Court had not to intervene to decide the merits of the case because of the doctrine of "judicial restraint"[97].

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[96] Section 36 of the Competition Act makes damages recoverable for an injury caused by a violation of Part VI of the Act (criminal offences) or failure to comply with a cease and desist order issued by the Competition Tribunal or an order issued by any other court. Again, section 62 provides for a civil right of action only against offences embodied in Part VI of the Act.

[97] T.U.A.C. v. C.A.S.-Caisse Inc., C.S. 500-05-014157-893, rendered by Mr. Justice Charles A. Phelan on March 2, 1990. The case is pending on appeal.

This scheme differs with the enforcement process in force in the United States where sections 4 and 16 of the Clayton Act allow private plaintiffs to obtain injunctive relief and recover treble damages for a violation of section 7 of the Clayton Act[98]. Recently, the U.S. Supreme Court ruled that private plaintiffs under section 16 of the Clayton Act are entitled to a divestiture order in merger cases subject to the criteria generally considered by courts in granting injunctive relief. U.S. Courts have been fairly receptive to private plaintiffs inter alia by according them the status of "private attorney general"[99].

In spite of the fact that no specific right of action is provided to private plaintiffs to enforce Part VIII of the Competition Act, the Director has important powers for monitoring merger activity. For instance, the Competition Act requires parties with assets or net revenues above a certain threshold contemplating certain types of transactions to

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[98] See Bellemare, Daniel Martin, "Les récents développements concernant les recours privés en droit de la concurrence au Canada et aux États-Unis" in Développements récents en droit commercial (1991), Les Éditions Yvon Blais Inc.

[99] California v. American Stores Company et al., 110 S. Ct. 1853 (1990); Associated General Contractors of California Inc. v. California State Council of Carpenters et al., 459 U.S. 519 (treble damage action); Gulf and Western Industries Inc. v. Great A & P Co. Inc., 476 F. 2d 687 (injunctive relief). The issue of standing was discussed recently by the U.S. Supreme Court in Cargill Inc. v. Monfort of Colorado Inc., 107 S. Ct. 484 (1986).

prenotify the Director[100]. If the Director is of the view that a proposed merger is likely to lessen competition substantially he may apply to the Tribunal to prevent the transaction (paragraphs 92(1)(e)(i) and (ii)). In the case of a completed merger he may, within the limitation period of three years, apply to the Tribunal either for a dissolution or a divestiture order (paragraphs 92(1)(f)(i) and (ii))[101].

Besides litigation before the Tribunal, the Director may alternatively opt for negotiated solutions. If the Director is convinced that the merger clearly is not likely to restrict competition he can deliver an advance ruling certificate pursuant to subsection 102(1) of the Act. The issuance of a certificate precludes the Director from challenging the merger before the Tribunal if it is completed in the year following issuance. This measure increases administrative efficiency since it need not to be approved by the Tribunal. Whether the

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[100] Competition Act, Part IX.

[101] In Alex Couture Inc. et al. c. Le Procureur Général du Canada et al., [1990] R.J.Q. 2668, the Superior Court of the Province of Quebec ruled that the structure of the Competition Tribunal is inconsistent with certain provisions of the Canadian Charter of Rights and Freedoms (section 11 the right to an independent and impartial tribunal) and of the Canadian Bill of Rights (paragraph 2e)). The powers of the Tribunal to prevent or dissolve a merger were also deemed to be inconsistent with paragraph 2d) of the Canadian Charter of Rights and Freedoms which prevents state actions limiting freedom of association. The case is pending on appeal.

Director should be conferred such a large discretionary power remains open to debate.

Another avenue available to the Director is to apply to the Tribunal for a consent order. A consent order is an agreement between the Director and respondents whereby they ask the Competition Tribunal to issue an order as requested so as to remove the anticompetitive concerns that a merger may raise. It is not a mere formality; the Tribunal can either enter an order according to the will of the parties or refuse to do so. The consent order must be enforceable and effective enough to ensure that the merger is not likely to lessen competition substantially although it need not be the best possible solution in the eyes of the Tribunal[102].

Only four applications have been filed before the Competition Tribunal for the approval of consent orders submitted by the Director and the parties involved in a merger. We will review each of them summarily.

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[102] D.I.R. v. Palm Dairies Ltd. et al., 12 C.P.R. (3d) 540; D.I.R. v. Air Canada et al., 27 C.P.R. (3d) 476.

(i) Palm Dairies

On June 17, 1986, 340280 Alberta Limited entered into a purchasing agreement with Palm Dairies Limited whereby the former would purchase the latter. Following an inquiry into the transaction the Director of Investigation and Research applied to the Competition Tribunal for an interlocutory order to prevent the completion of the deal. Subsequently, the Director and the parties submitted a consent order to the Tribunal for approval. It was the first application filed with the Competition Tribunal under the new merger provisions of the Competition Act[103].

340280 Alberta Limited was owned by four co-operatives of dairy products, namely Fraser Valley Milk Producers Cooperative Association, Northern Alberta Dairy Pool Limited, Central Alberta Dairy Pool and Dairy Producers Cooperative Limited, each with 25% of the capital shares. Basically, the consent order provided that the co-ops would lower their interests in the numbered company to 50%; the remaining 50% had to be held by another company, i.e. 340379 Alberta (P.M.G.). Furthermore, there was a whole set of provisions imposing behavioral constraints upon the parties in order to keep Palm Dairy an independent competitor in the market.

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[103] D.I.R. v. Palm Dairies Ltd. et al., 12 C.P.R. (3d) 540.

The Competition Tribunal denied the application. It came to the conclusion that the reorganization of 340280 Alberta Limited and the restrictions contemplated in the consent order were ineffective at preventing the merger from being likely to lessen competition substantially. The Tribunal also pointed out that the terms of the order were vague making it almost impossible for respondents to comply with it. Madam Justice Reed was concerned with the terms of the order because of possible sanctions under the Competition Act (both civil and criminal) for noncompliance with a consent order.

(ii) Westinghouse/ABB[104]

In 1989, Asea Brown Boveri Inc. acquired assets of Westinghouse Canada Inc. These assets were plants for manufacturing electrical transmission and distribution equipment destined to power utilities. The plants were located in Ontario in the cities of Hamilton and Guelph and were owned by Transelectrix Technology Inc., a subsidiary of Westinghouse Canada Inc. The Director filed an application before the Competition Tribunal against ABB Canada, WECAN and TTI for the

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[104] D.I.R. v. Asea Brown Boveri Inc. et al., CT-89/1 (Consent Order dated June 15, 1989); (reasons for Consent Order dated September 6, 1989). Modifications to the initial order: D.I.R. v. Asea Brown Boveri Inc. et al., CT-89/1 (Consolidated Consent Order of June 15, 1989 as amended on December 18, 1989); (reasons for the Order of December 18, 1989 Varying the Consent Order of June 15, 1989).

approval of a consent order. He was of the opinion that the merger could lessen competition substantially in a market described as the manufacturing and sale of "Subject Power Transformers" in Canada. The relevant product market included two submarkets, i.e. "large transformers" and "very large transformers".

The merger conferred to ABB Canada a monopoly over the manufacture and sale of very large transformers as well as 75% of the whole market for subject power transformers in Canada. Furthermore, there were important entry barriers in the market in the form of high tariffs and substantial initial investment requirements. Nevertheless, the Director entered into an agreement with the parties providing that the assets of ABB Canada and WECAN had to be held separately until the obtention of tariff reduction from the relevant government agencies. If such reduction was not obtained within the period set in the consent order the parties had to divest the assets. The Tribunal was of the view that the consent order met the test enunciated in Palm Dairies.

(iii) Gemini[105]

On June 1, 1987 Air Canada and Canadian Pacific Airlines merged their computer reservation systems, Reservec II and Pegasus. The new merged entity was named Gemini Group Automated Distribution Systems Inc. At the beginning of 1988 Pacific Western Airlines Corporation amalgamated two of its subsidiaries Pacific Western Airlines Limited and Canadian Pacific Airlines[106] in order to form Canadian Airlines International. Air Canada and Canadian Airlines International became equal partners in Gemini thereafter. Later PWA Corporation acquired Wardair which had serious financial difficulties.

In March 1988, the Director of Investigation and Research filed an application before the Competition Tribunal seeking a divestiture order against the merger. At that time, Air Canada and Canadian Airlines International shared more than 90% of the Canadian domestic airline market. The merger provided these two airlines companies with approximately 80% of the computer reservation service market in Canada. In the course of the proceedings, the Director retreated and

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[105] D.I.R. v. Air Canada et al., 27 C.P.R. (3d) 476.

[106] The Director was monitoring the merger when GEMINI was established. (Source: D.I.R. Annual Report for the year ended March 31, 1987, Consumer and Corporate Affairs Canada, at pp. 16-17).

negotiated a consent order with the parties. In short, the consent order contains provisions that prevent Air Canada and CAI from using Gemini predatorily against competitors; enjoins Gemini to provide non-discriminatory access to its computer reservation system to CRS vendors; and prevents collusion between Air Canada and CAI by forbidding exchange of sensitive market information. The Tribunal granted the order sought because it deemed that it was enforceable and that the anti-competitive consequences of the merger would "in all likelihood, been eliminated".

(iv) Imperial Oil-Texaco[107]

On January 20, 1989, Imperial Oil Limited acquired the shares of Texaco Canada Inc. The transaction was subject to the notification procedure embodied in Section IX of the Competition Act. After having ascertained the likely anti-competitive consequences of the merger, the Director submitted a consent order to the Competition Tribunal on June 29, 1989. The day after, he filed a consent interim order so as to prevent Imperial and Texaco from amalgamating until final approval of the consent order by the Competition Tribunal. On July 4, 1989, the Tribunal issued a hold separate order

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[107] D.I.R. v. Imperial Oil Ltd. (Consent Order and Reasons and Decision), Competition Tribunal, January 26, 1990 (CT-8913).

enjoining the parties from "fully integrating" their assets unless such integration was authorized by the Tribunal or the Director[108].

After this investigation, the Director concluded that the transaction was likely to lessen competition substantially in the downstream sector of the oil industry (i.e. refining and retailing). In his view, the merger was unlikely to lessen competition substantially in the upstream sector (i.e. exploration and crude oil production); thus the consent order and the hold-separate order were only directed at the refining and retailing levels. The Competition Tribunal had no opportunity to review the decision of the Director as to the upstream sector of the industry.

On November 10, 1989, the Competition Tribunal issued a provisional decision as to the consent order sought by the parties and the Director[109]. The Tribunal refused to approve the consent order because it deemed that it was inadequate to cure the anticompetitive effects of the merger especially in the Atlantic region. Madam Justice Reed was very critical as to the management of the hold-separate order by the Director pending approval of the consent order by the Competition

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[108] D.I.R. v. Imperial Oil Ltd. (Consent Interim Order), Competition Tribunal, July 4, 1989 (CT-89/3).

[109] D.I.R. v. Imperial Oil Ltd., 45 B.L.R. 1.

Tribunal[110]. So on November 28, 1989, the Director filed another consent order before the Competition Tribunal.

The revised consent order was approved by the Tribunal on January 26, 1990. The merger was allowed to proceed under specific conditions, i.e. assets had to be divested at the refining and retail levels. Imperial was required to divest every asset in the Atlantic region including the Dartmouth refinery. It was also ordered to divest itself of over 500 gasoline outlets countrywide; moreover, Imperial was required to supply independent gasoline dealers in Ontario and Québec during a certain period of time specified in the order. Notwithstanding the Tribunal's final approval of the consent order the Imperial-Texaco saga has undermined the credibility

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[110] At page 13 of the provisional decision (supra, note 109), Madam Justice Reed wrote:

> "The tribunal also wants to comment on the approach the Director has taken, in this case, with respect to the hold separate and apart requirements imposed on Imperial. Those were in what I might call full force and effect only until the Director had identified the solution he considered should cure the anti-competitive effects of the merger. Subsequent to that time he allowed the merger in many ways to be consummated. I have to tell you that one Tribunal member, at least, considers this to be highly presumptuous, if not arrogant. The message that might be taken by some people from that conduct is that the Director has determined to approve the merger regardless of what the Tribunal decides."

of the merger review process set by the Bureau of Competition Policy[111].

The consent order and the advance ruling certificate process in the Competition Act were enacted with the purpose of subjecting mergers which are likely to lessen competition substantially to public scrutiny. Hence, we can question the appropriateness and the legality of administrative settlements entered into by the Director and the merging parties. The Directors said publicly on several occasions that he is

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[111] Former Deputy Director of Investigation and Research, Roy M. Davidson, criticized the Director of Investigation and Research for having negotiated a settlement with Esso and Texaco. At the National Conference on the Centenary of Competition Law and Policy in Canada held in Toronto on October 24 and 25, 1989 he said:

> "The consent application to the Tribunal that is being made in the case of Imperial Oil's acquisition of Texaco, seems to indicate that if you are big enough in Canada, you don't have to worry much about the prohibition of a merger, only about the terms under which it will be allowed. (...)
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> Given that the results of the most exhaustive inquiry ever undertaken into competition in the petroleum industry are a matter of recent public record; given that they underline the significance of high levels of concentration and the presence of anticompetitive practices in the industry; and given that the D.I.R. has nevertheless decided to seek a negotiated settlement, rather than a prohibition of the acquisition of Texaco by Imperial Oil, one is entitled to ask if any prohibition will ever be sought at all in a case where a company is large and offers to negotiate."

Davidson, Roy M., "Independence Without Accountability Won't Last", Paper prepared for the National Conference on the Centenary of Competition Law and Policy in Canada, Toronto, October 24-25, 1989, pp. 22 and 27.

willing to accept undertakings from parties in the form of divestiture of assets or stocks pre- or post-merger[112]. By doing so the Director bypasses the consent order process established by law[113] and deprives interested parties from intervening before the Competition Tribunal to express their concerns[114].

2.2 The Scope of the Merger Provisions of the Competition Act

An evaluation as to the strength of the merger provisions embodied in the Competition Act is a perilous exercise in the present context. Unlike conspiracy (section 45) or resale price maintenance (section 61) for which a good body of case law exists, there is not a single decision of the Competition Tribunal having constructed the several provisions of the Act dealing with mergers. As mentioned previously, the

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[112] See, inter alia, "The Merger Provisions", Information Bulletin N° 1, D.I.R. Consumers and Corporate Affairs Canada, June 1988, p. 6.

[113] In Canada (D.I.R.) v. NFLD. Telephone, [1987] 2 S.C.R. 466 the Supreme Court of Canada ruled that "Everything that a public officer, whose office has been created and defined by statute, does in his official capacity must find its ultimate legal foundation in statutory authority" (p. 478).

[114] In American Airlines v. Competition Tribunal, [1989] 1 S.C.R., the Court maintained the decision of the Federal Court (Appeal Division) to the effect that subsection 9(3) of the Competition Tribunal Act, which allows intervenors to make representations if authorized by the Tribunal, must be interpreted so as to enable third parties to introduce evidence and cross-examine witnesses.

Competition Tribunal has only issued consent orders submitted for approval by the Director and the merging parties.

Hence, important issues pertaining to the merger analysis remain unsettled from a legal standpoint. Among these issues are the importance of market share and concentration, the relevance of each factor listed in section 93 and the type of efficiencies admissible. In order to resolve these questions we must rely to a certain extent on articles of commentators and on the merger guidelines released recently by the Director of Investigation and Research[115]. Because these sources do not have the same authority as decisions of the Competition Tribunal we must approach them with caution.

An interesting aspect of the literature available on antitrust regulation of mergers in the Canadian context is the interpretation of subsection 92(2) of the Competition Act suggested by some commentators. Subsection 92(2) stipulates that one cannot assess the anticompetitive impact of a merger by referring exclusively to evidence showing that it will result in a high level of concentration or confer a large

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[115] "MERGER ENFORCEMENT GUIDELINES", Director of Investigation and Research, Competition Act, C.C.C. (Information Bulletin N° 5), March 1991.

market share[116]. Most commentators have taken the position that this subsection was introduced into the Act in order to prevent the implementation of the prima facie rule of illegality framed by the U.S. Supreme Court in Philadelphia National Bank.

In September 1987, former Director of Investigation and Research Calvin S. Goldman delivered a speech on the new merger sections of the Competition Act at the Faculty of Law of McGill University. In his statement Mr. Goldman pointed out that concentration and market share are not "the sole determinants and must be considered along with other qualitative aspects"[117]. Although he did not refer specifically to Philadelphia National Bank, he implicitly rejected the notion that market share and concentration could be determinant if not rebutted by countervailing evidence.

Referring directly to subsection 92(2) (formerly subsection 64(2)) Warren Grover and Robert Kwinter argued in an article in the Canadian Bar Review that "the new

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[116] "92.(2) For the purpose of this section, the Tribunal shall not find that a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially solely on the basis of evidence of concentration or market share."

[117] Goldman, Calvin S., "The Merger Provisions of the New Competition Act: The Experience to Date", McGill Meredith Memorial Lectures (1987), p. 259.

Competition Act includes a number of factors which the Tribunal should consider and which should ensure that no presumptions based on a Canadianized HHI will arise"[118]. Mr. Grover reiterated this point in October 1989 at the National Conference on the Centenary of Competition Law where he emphasized once again that the presence of subsection 92(2) reflects a choice in favour of a different approach toward structural factors in merger analysis[119].

At a symposium held in Toronto on June 1988 Howard I. Wetston, currently occupying the function of Director of Investigation and Research, was straightforward: "the provision in section 92(2)... reflects an implicit legislative rejection of the orthodox approach to the "structure-conduct-performance paradigm"[120]. He explained his position by referring to historical and economic factors. In short he claimed that the U.S. antitrust tradition favouring a decentralized decision-making process in the economy is incompatible with the Canadian economic reality which requires

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[118] Grover, Warren and Kwinter, Robert, "The New Competition Act", 66 Canadian Bar Review 267 (1987), at 274.

[119] Grover, Warren and Quinn, Jack, "Recent Developments in Canadian Merger Law", Paper presented at the National Conference on the Centenary of Competition Law and Policy in Canada", Toronto, October 24-25, 1989, pp. 14-15.

[120] Mathewson, Trebilcock, Walker, "The Law and Economics of Competition Policy", The Fraser Institute (1990), Commentary by Howard I. Wetston (pp. 369-372), at pp. 369-70.

amalgamation of enterprises to serve a small population throughout a large territory. He rejected a structural approach for reviewing mergers because errors in applying a presumptive test of illegality would be costly given the small size of the Canadian economy[121].

R.S. Khemani, an economist with the Economics and International Affairs Branch in the Bureau of Competition Policy, voiced similar concerns as to the importance of market share and concentration. He claims that a structural approach to horizontal merger analysis relying on ratio or index of concentration is unsound is a country with a small economy like Canada for two reasons. First, even if the Canadian economy is composed mainly of oligopolistic markets several enterprises therein are operating below the minimum scale of efficiencies. This makes difficult distinguishing instances where high prices are due to inefficiencies resulting from small production scale as opposed to conscious parallelism. Second, Khemani observes that divergences in economic studies on oligopolies warrant that they be used carefully especially in the Canadian context. He concludes that the implementation of thresholds based on market share or concentration level

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[121] Subsection 92(2) is also discussed by Paul S. Crampton, Mergers and the Competition Act, Carswell (1990), at pp. 393-399.

could lead to preventing mergers enhancing efficiency as well as allowing mergers that could confer market power[122].

Finally, the Merger Guidelines issued by the Bureau of Competition Policy in April 1991 also express an adverse attitude toward a structuralist approach to mergers and acquisitions. As a general principle one can read at the outset of subsection 4.2.1 of the guidelines: "information which demonstrates that market share or concentration will be high cannot provide a sufficient basis, in and of itself, to justify a conclusion that a merger is likely to prevent or lessen competition substantially"[123]. It is also indicated in the same section that a merger may raise concerns when it provides the merging firm with a market share of more than 35%[124]. Moreover, the Director considers that a shared monopoly situation may arise when the merger raises the four-firm concentration ratio above 65%; then if the merger confers to the merging firm a market share superior to 10% it may also

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[122] Khemani, R.S., "Merger Policy in Small vs. Large Economies", (Preliminary Draft). Prepared for the National Conference on the Centenary of Competition Law and Policy in Canada, October 25, 1989, Toronto, Canada.

[123] Merger Guidelines, supra, note 115, p. 21.

[124] This threshold is the same no matter the ratio or index of concentration in the market. There is no indication as to what constitutes a concentrated or unconcentrated market.

raise concerns[125]. Yet, these structural elements must be evaluated concurrently with the whole set of factors enumerated in section 93 of the Competition Act.

Although concentration and market share cannot be decisive in absence of countervailing evidence weakening their relevance, the Director indicates in different sections of the guidelines that some factors individually may be taken into consideration in order to decide not to challenge a merger. These factors are: entry barriers, failing firm and remaining competition. Interestingly, the Director may rely on one of these factors only to decide not to challenge a merger. In such circumstances, he will not apply to the Tribunal even if a merger raise concentration substantially, confer a large market share and increase seriously the risk of conscious parallelism in the market.

In section 4.4.1 of the Guidelines the Director has elaborated a test whereby he decides whether the failing firm defence is applicable in a specific situation. If the test is met the Director will conclude that the merger is not likely to lessen competition substantially. It must be mentioned that the defence is not only available in the case of a failing firm, but also where the target firm intends to exit

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[125] Merger Guidelines, supra, note 115, p. 21.

a market, inter alia, because of low profits. In F.T.C. v. Warner Communications Inc.[126] the Court of Appeals for the Ninth Circuit criticized the extension of the failing firm doctrine to include a "weak company defence".

In section 4.6.1 of the guidelines the Director discusses entry barriers. He states in this section that generally absence of entry barriers will be decisive. Such a conclusion is sound for without entry barriers the merging firm would not be able to exercise market power. But evidence of a high level of concentration, entry barriers and absence of gains in efficiency will not alone justify challenging a horizontal merger. Similarly, in section 4.7 of the guidelines, it is mentioned that if the level of effective competition would likely remain the Director will not challenge the merger. This is awkward since, as we have mentioned before, the level of competition in an industry is in general related to the number of competitors in the market.

Recently, the Director of Investigation and Research filed two applications before the Competition Tribunal with respect to mergers having occurred in British Columbia and Ontario. The first application was filed on November 29, 1990 against Southam Inc. concerning a complex array of direct and

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[126] 742 F. 2d 1156 (1984).

indirect stock acquisitions made in several enterprises involved in the business of publishing in the Lower Mainland of British Columbia[127]. The second application was filed on February 15, 1991 against Hillsdown Holdings (Canada) Ltd. and Canada Packers because the former acquired 56% of the latter's shares[128]. In the statement of grounds and material facts presented before the Tribunal in support of the two applications the Director seems determined to introduce evidence pertaining to each element listed in section 93 of the Competition Act in order to persuade the Tribunal to issue orders pursuant to subsection 92(1) of the Competition Act. This approach is unrealistic. It will be interesting to see what the reaction of the Tribunal will be.

Lawson A.W. Hunter[129] is the only analyst who suggested a different approach to the interpretation of the merger provisions of the Competition Act. Without proposing a prima facie rule based on market share and concentration ratio, Mr. Hunter claimed that these two factors should be relied on as prime indicators of the likely effect of a horizontal

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[127] D.I.R. v. Southam Inc. et al., CT-90/1.

[128] D.I.R. v. Hillsdown Holding Canada et al., CT-91/1.

[129] Lawson A.W. Hunter was Director of Investigation and Research from 1981 to 1985.

merger on competition[130]. Accordingly, he urged the Director to release guidelines with thresholds expressed in terms of market shares and remaining number of players in the market. Yet, Mr. Hunter clearly stated that these guidelines would only be "warning lights" permitting the identification of mergers prone to raise concerns under the Act.

As to the factors listed in section 93 he argued that the most significant is barriers to entry because it is the element which is the more likely to indicate if a merger will in all likelihood transform the structure of the market over a long period of time. Moreover, he insisted that the existence of entry barriers is easier to establish than many other elements. Then he added that remaining competition, the removal of a vigorous and effective competitor and the extent of change and innovation in the market are far less important because they are intrinsically related to market share, concentration and entry barriers.

Mr. Hunter also made useful comments with respect to foreign competition and cross-elasticity of demand, two

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[130] Professor Leonard Waverman also expressed a similar point of view when he affirmed in a paper presented at a conference in Toronto: "Regardless of what the Act states, combined market share is the litmus test". Insight Conference (1988), The Impact of Competition Policy on Mergers and Acquisitions - Article IV: "Economics and Statistics in Merger Review Under the Canadian Competition Act", p. 15.

factors enumerated in section 93. Basically, they offer guidance in the definition of the relevant product and geographic markets. He conceives the failing firm factor as a defence which is very relevant in determining whether a merger is likely to lessen competition substantially. Lastly, he expressed the view that efficiencies must be considered but might be hard to demonstrate[131].

The approach suggested by Lawson A.W. Hunter is more consistent with the purpose and the merger provisions of the Competition Act. It would provide predictability as to enforcement and make mergers justiciable before the Competition Tribunal. In the next two sections we will analyse the relevant sections of the Competition Act dealing with mergers in order to determine whether a structural approach is consistent with this legal framework.

2.3 Market Share and Concentration in the Context of the Competition Act

Several sections embodied in the Competition Act indicate that the prima facie approach in Philadelphia National Bank is not inconsistent with the merger provisions of the Act. In this perspective we will discuss separately the purpose clause

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[131] Hunter, Lawson A.W., "The New Merger Provisions of the Competition Act – Certainty or Random Walk", McGill Meredith Memorial Lecture (1987).

(section 1.1); subsection 92(2) dealing with market share and concentration; prenotification in Part IX; and the factors enumerated in section 93.

2.3.1 The Purpose Clause (Section 1.1)[132]

Section 1.1 of the Competition Act provides some insight into the scope of the merger provisions. We must consider the general principles embodied in this section for guidance because it illustrates the parameters of the antitrust policy pursued by Parliament. Undoubtedly, the prime objective of the Competition Act is to preserve an economic environment in which competition can work as a self-regulating mechanism. In other words, the Competition Act aims at preserving competition in the marketplace by imposing interfirm rivalry as a standard code of conduct. This basic objective of competition law was recognized throughout the century by the judiciary in Canada[133].

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[132] "1.1 The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and products choices."

[133] Weidman v. Shragge (1912), 46 S.C.R. 1, p. 43 (Anglin, J.): "The benefit of competition is the right of every one"; Container Materials Limited v. Her Majesty the Queen, [1942] S.C.R. 147, p. 152 (Duff, C.J.): "The enactment before us, I

Three sub-objectives enumerated within section 1.1 indicates that the Competition Act puts emphasis on interfirm rivalry. These sub-objectives are: ensuring that the Canadian economy functions efficiently and is able to adapt to new challenges; enabling small business to be a dynamic force in the market; and ensuring that market forces will yield to consumers competitive prices and a vast choice of products. The general statement in favour of competition in the first part of section 1.1 means that the benefits enumerated in the previous sentence are likely to result by stimulating interfirm rivalry.

The purpose clause shows that the major objective of the Competition Act is to prevent one or several competitors from acquiring market power[134] by engaging in anticompetitive practices. A priori, the several provisions of the Act must be construed so as to foster individual decisions by

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have no doubt, was passed for the protection of the specific interest in free competition... Speaking broadly, the legislation... is aimed at protecting the public interest in free competition"; Howard Smith Paper Mills Limited v. Her Majesty the Queen, [1957] S.C.R. 407 (Taschereau, J.): "The public is entitled to the benefit of free competition, and the prohibitions of the Act cannot be evaded by good motives"; Regina v. Canadian General Electric Company Ltd. et al., 75 D.L.R. (3d) 664, p. 674: "... the basic parliamentary policy, as revealed in the Combines Investigation Act, has always been that a full competitive market shall serve as the principal regulator of economic activity...".

[134] U.S. v. du Pont Co., 351 U.S. 377, p. 391: "Monopoly power is the power to control prices or exclude competition".

competitors instead of cooperation. Preference is given to the expansion of a firm in the market through internal growth. Any increase in market share must be related to a superior competitive performance. Profits made by striving competitors are reinvested and contribute to strengthening position in the market. Hence, section 1.1 favours internal growth over acquisitions and cooperation because it is the expression of superior competitive performance[135].

Market power is not per se illegal under antitrust laws. What is relevant from an antitrust standpoint is not size per se, but rather how size has been achieved and how it is used. In D.I.R. v. Nutrasweet Co. et al., the Competition Tribunal had to decide whether Nutrasweet had abused its dominant position within the Canadian aspartame market[136]. As a matter of law the Tribunal ruled that for an order to be issued under subsection 79(1) of the Competition Act the Director must establish that respondent has market power coupled with practices either "predatory, exclusionary or disciplinary" aimed at maintaining or enhancing a dominant position within a relevant market.

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[135] See Bork, Robert H., The Antitrust Paradox, supra, note 85, at p. 199.

[136] D.I.R. v. Nutrasweet Co. et al., 32 C.P.R. (3d) 1.

In U.S. v. Grinnell Corp.[137], Mr. Justice Douglas distinguished between a firm which has acquired or maintained market power wilfully through purchasing or eliminating competitors and expansion "as a consequence of a superior product, business acumen, or historic accident"[138]. In this case, Grinnell Corp. had acquired control over 87% of the accredited central station service business in the United States by taking over competing firms and entering into market division agreements with competitors. The existence of monopoly power was inferred from Grinnell's market share[139].

The purpose clause also takes into consideration the new economic reality that emerged worldwide in the eighties. Thus we must recognize that some Canadian firms operate on an international scale and that they can face competition in Canada from foreign competitors. Section 1.1 acknowledges that a market may have an international dimension making it necessary for Canadian enterprises to consolidate in order to export their products or increase their competitiveness

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[137] 384 U.S. 563.

[138] U.S. v. Grinnell, 384 U.S. 563, at 571.

[139] Several authors have discussed the issue of market power: Landes, William M., "Market Power in Antitrust Cases", 94 Harvard Law Review 937; Schmalense, Richard, "Another Look at Market Power", 95 Harvard Law Review 1789; Kaplow, Louis, "The Accuracy of Traditional Market Power Analysis and a Direct Adjustment Alternative", 95 Harvard Law Review 1817; Brennan, Timothy J., "Mistaken Elasticities and Misleading Rules", 95 Harvard Law Review 1849.

abroad. This is an indication that a merger should not be prevented only because it would create a very large firm at the national level without regard to the geographic market in which it operates.

This principle is illustrated by a U.S. court decision Consolidated Gold Fields v. Anglo American Corp.[140]. In 1988, Minorco S.A. launched a hostile takeover bid for the acquisition of the shares of Consolidated Gold Fields. Minorco S.A. already held a 30% stake in Consolidated Gold Fields; in turn, Minorco was controlled by Anglo American Corporation of South Africa Limited (39%) and De Beer Consolidated Mines Ltd. (21%). Consolidated Gold Fields filed a motion for an interlocutory injunction to prevent the takeover on the grounds, inter alia, that it would violate section 7 of the Clayton Act. Because the parties involved were operating gold mines in the United States, Australia and South Africa it found that the relevant geographic market was "all non communist gold mining" countries[141].

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[140] 698 F. Supp. 487, confirmed by 871 F. 2d 252.

[141] Consolidated Gold Fields P.L.C. v. Minorco S.A., 871 F. 2d 252, p. 260. In the matter of Asea Brown Boveri Inc., supra, note 104, the Competition Tribunal found that the suppression of tariff barriers would enlarge the geographic market for subject power transformers so as to include the United States and Canada.

The fact that a geographic market may have an international dimension, as stipulated in section 1.1, does not mean that the Competition Act aims at protecting international competitors at the expense of domestic competition. The mention of world markets and foreign competition must be read together with paragraph 93a) and section 96 (gains in efficiency) of the Competition Act. Clearly, the purpose clause indicates that the objective of the Competition Act is to preserve and maintain market structure compatible with interfirm rivalry – i.e. "the protection of competition, not competitors"[142].

2.3.2 Subsection 92(2) of the Competition Act

Paradoxically, the presence of subsection 92(2) within the merger sections supports the contention that reliance on the structure-conduct-performance paradigm was intended, not the opposite. An interpretation of subsection 92(2) rejecting the application of the paradigm to the Canadian merger review process reflects a misunderstanding of the analytical framework articulated by the U.S. Supreme Court in Philadelphia National Bank. This is something that must be clarified in order to construe subsection 92(2) according to

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[142] Brown Shoe Co. v. U.S., 370 U.S. 294, at p. 320.

the legal and economic philosophy underlying the Competition Act.

Subsection 92(2) stipulates only that the Competition Tribunal cannot make a finding that a merger is likely to lessen competition substantially by simply considering evidence introduced by the Director pertaining to an increase in market share or concentration. This subsection forbids the Tribunal from elaborating a per se rule of illegality based on market share and concentration whether it is expressed in terms of concentration ratios (based either on the market share of the four or eight largest firms) or on the Herfindahl Index[143]. This subsection was included in section 92 in order to prevent merger analysis from becoming a purely mechanical exercise in mathematics.

Courts in the U.S. have used wording similar to that embodied in subsection 92(2) to formulate the prima facie rule of illegality. A review of some of the decisions rendered by District Courts and Court of Appeals in the eighties is illus-

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[143] For articles discussing the use of the Herfindahl-Hirschman Index, see inter alia: Calkins, Stephen, "The New Merger Guidelines and the Herfindahl-Hirschman Index", 71 California Law Review 402 (1983); Cohen and Sullivan, "The Herfindahl-Hirschman Index and the New Antitrust Merger Guidelines: Concentrating on Concentration", 62 Texas Law Review 453 (1983-84); Ordover, Sykes and Willig, "Herfindahl Concentration, Rivalry, and Mergers", 95 Harvard Law Review 1857 (1982).

trative. Throughout this period, the ruling of Mr. Justice Brennan in Philadelphia National Bank was reiterated. Here are some examples:

. In U.S. v. Baker Hughes Inc.[144], the U.S. Court of Appeals for the District of Columbia Circuit maintained the decision of the Trial Court rejecting an action for a permanent injunction against two competitors which merged. In the years immediately preceding the transaction Tamrock (the acquiror) had maintained a 40.8% market share; Secoma (the acquiree) had a 17.5% stake. Just before the merger they had controlled together 76% of the relevant market. The pre-merger H.H.I. was 2878 and the post-merger H.H.I. 4303, an increase of 1425 points.

Inspite of this strong prima facie case both courts came to the conclusion that defendants had rebutted the presumption by introducing evidence showing low entry barriers, purchasers' bargaining power and the misleading nature of the structural factors relied on by the government to sustain its prima facie case[145].

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[144] 908 F. 2d 981 (1990).

[145] In U.S. v. Baker Hughes Inc., 908 F. 2d 981 (1990), Mr. Justice Thomas wrote at p. 948:

"The Supreme Court has adopted a totality-of-the-circumstances approach to the statute, weighing a variety of factors to determine the effects of particular

. In U.S. v. Calmar Inc.[146], the U.S. District Court for the District of New Jersey denied a preliminary injunction to the government seeking to prevent the acquisition by Calmar Incorporated of Realex Corporation. The merger would provide the merging firm with a 50% market share. Pre-merger, the four-firm-concentration ratio was 78% and the H.H.I. 1564. After the merger the Cr^4 would have been 85% and the H.H.I. 2302, i.e. up by 738 points.

The Court found that defendants had demonstrated that the merger was not likely to lessen competition substantially because there were no entry barriers in the market[147].

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transactions on competition. That the government can establish a prima facie case through evidence on only one factor, market consideration, does not negate the breadth of this analysis. Evidence of market concentrations simply provides a convenient starting point for a broader inquiry into future competitiveness...".

[146] 612 F. Supp. 1298 (1985).

[147] At p. 1301 of U.S. v. Calmar, supra, one can read:

"If the definition of the product and geographic market shows a high degree of concentration resulting from a merger, a prima facie case of illegality has been established... However... it still may be shown that the merger will not result in a substantial lessening of competition because factors at work in the market will make it unlikely that the remaining producers in the market will be able to exercise market control."

. In U.S. v. Waste Management Inc.[148], the Court of Appeals for the Second Circuit reversed a trial court which held that a merging firm with 48% of the market had not reversed the prima facie case of illegality based on market share and concentration. Defendants had argued that barriers to entry were non-existent.

The Court of Appeals ruled that they had reversed the presumption with such evidence and that the merger did not contravene section 7 of the Clayton Act[149].

However, in other instances, Courts came to the conclusion that defendants failed to prove that concentration and market shares were not probative[150]. All these decisions

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[148] 743 F. 2d 976 (1984).

[149] In U.S. v. Waste Management, supra, Mr. Justice Winter remarked at p. 981:

> "A post-merger market share of 48.8% is sufficient to establish prima facie illegality... large market shares are a convenient proxy for appraising the danger of monopoly power resulting from a horizontal merger... Under its rationale, a merger resulting in a large market share is presumptively illegal, rebuttable only by a demonstration that the merger will not have anti-competitive effects."

[150] Consolidated Gold Fields PLC et al. v. Minorco S.A., 871 F. 2d 252; State of California v. American Stores Co., 872 F. 2d 837; U.S. v. Rockford Memorial Corp., 898 F. 2d 1278; R.C. Bigelow Inc. v. Unilever N.V. et al., 867 F. 2d 102; F.T.C. v. Elders Grain Inc., 868 F. 2d 901; Remington Products Inc. v. North American Philips Corporation et al., 717 F. Supp. 36; Tasty Baking Company et al. v. Ralston Purina et al., 653 F. Supp. 1250; Hospital Corporation of America v.

clearly demonstrate that a prima facie rule of illegality based on the variation in market structure is not incompatible with a multi-factor approach for reviewing horizontal mergers. Thus subsection 92(2) cannot be construed as a negation of the structure-conduct-performance paradigm. Indeed, when we read subsection 92(2) in connection with the factors listed in section 93, it appears that we have codified the methodology used by U.S. courts in applying section 7 of the Clayton Act to horizontal mergers.

2.3.3. Prenotification (Part IX - Competition Act)

Since July 15, 1987, mergers of a certain size must be notified to the Director of Investigation and Research before being completed[151]. Parties with assets or gross revenues of 400 million dollars or more[152] planning either:

(i) an acquisition of voting shares in an operating business in Canada with assets or gross revenues superior to 35 million dollars[153];

F.T.C., 807 F. 2d 1381; Laidlaw Acquisition Corporation v. Mayflower Group Inc., 636 F. Supp. 1513; White Consolidated Industries Inc. v. Whirlpool Corporation, 612 F. Supp. 1009.

[151] Canada Gazette (Registration SI/87-139; July 8, 1987).

[152] Competition Act, subsection 109(1).

[153] In addition the proposed acquisition must confer to the acquiror more than 20% of the votes attached to all oustanding voting shares, or more than 50% if he already owns more than 20%, in the case of a publicly traded corporation.

(ii) an acquisition of assets in Canada whose value is superior to 35 million dollars or who can generate gross revenues of more than 35 million dollars[154];

(iii) a merger in Canada if the merging firm would have assets or gross revenues over 70 million dollars[155];

(iv) a joint venture in Canada if the unincorporated entity would have assets or gross revenues over 35 million dollars[156];

are subject to the prenotification provisions of the Competition Act.

Information must be provided in order to enable the Director to assess whether the merger is likely to lessen competition substantially. The law requires inter alia that information be supplied as to the type of transaction contemplated and the business objectives sought thereby; a list of suppliers and customers; a list of products manufactured or

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In the case of a private corporation the thresholds are 35% and 50% (Competition Act, subsection 110(3)).

[154] Competition Act, subsection 110(2).

[155] Competition Act, subsection 110(4).

[156] Competition Act, subsection 110(5).

distributed; documents filed with securities and exchange commissions[157]. Once this information is supplied the parties must wait between 7 and 21 days depending upon whether they filed a short or long form with the Director's office[158].

This procedure was inspired by section 7A of the U.S. Clayton Act. That section was enacted in 1976 and stipulates that the Federal Trade Commission and the Department of Justice (Antitrust Division) must be notified of stock and asset acquisitions where:

(i) the acquiring firm has net revenues or assets of 100 million dollars or more and the target firm 10 million dollars or more (vice versa);

and

(ii) the said acquisition would provide the acquiring firm with either 15% or more of the voting shares of the target firm or assets on amount of 15 million dollars or more.

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[157] Competition Act, sections 121 and 122.

[158] Competition Act, section 123.

The introduction of a prenotification procedure for mergers in the Competition Act is a clear indication that the Act is concerned with economic concentration within markets and its potential impact on competition. The prenotification procedure embodied in Part IX of the Act is a preventive mechanism destined to avert mergers prone to engender market power. The procedure is litigation-oriented, i.e. it is aimed at making a preliminary order relief an effective weapon against anti-competitive mergers. It reduces litigation costs substantially and places the Director in an advantageous position for challenging mergers likely to lessen competition substantially[159].

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[159] Premerger Notification: Reporting and Waiting Period Requirements, 52 Fed. Reg. 7066:

> "Thus the act requires that the agencies receive prior notification of significant acquisitions, provides certain tools to facilitate a prompt, thorough investigation, and assures an opportunity to seek a preliminary injunction before the parties are legally free to complete the transactions, which eliminates the problem of unscrambling the assets after the transaction has taken place."

See also Dennis, Roger J. (Special Assistant to the Assistant Attorney General, Antitrust Division), "The Premerger Notification Program – A First Look", Remarks before the New York Law Journal (Law Journal Seminars – Press), New York, October 16, 1978 at p. 1: "In passing the Act Congress made it clear that the Division and the F.T.C. should be given enough time and information so that all anticompetitive mergers could be attacked and enjoined before assets were irrevocably scrambled".

The concern of Parliament respecting increasing concentration is also illustrated by the statutory measures applicable in cases of non-compliance with the prenotification procedure. Completing a merger without notifying the Director is a criminal offence pursuant to subsection 65(2) of the Competition Act. Furthermore, paragraph 100(1)b) empowers the Competition Tribunal to issue a preliminary order against parties contemplating a proposed merger simply upon showing that they failed to comply with Part IX of the Competition Act. The Act gives paramount importance to preserving the ability of the Director to take remedial actions against a merger before it is completed.

The purpose of prenotification is best understood when we consider the state of antitrust laws at the time the new merger provisions were promulgated in 1986. Prior to June 1986, the antitrust aspect of mergers was subject to criminal law; pursuant to section 33 of the Combines Investigation Act[160] it was a criminal offence to complete a merger having or likely to have a detrimental effect on the public interest[161]. Not surprisingly the enforcement of this

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[160] 1970 R.S.C., c. C-23 as amended.

[161] Section 33 read:

> "33. Every person who is a party or privy to or knowingly assists in, or in the formation of, a merger or monopoly is guilty of an indictable offence and is liable to imprisonment for two years."

section was revealed to be totally unsuccessful. The Attorney General of Canada never managed to secure a single conviction between 1910 and 1986[162]; defendants entered guilty pleas on only two occasions[163].

It was absolutely inappropriate to attempt to regulate anticompetitive mergers through the process of criminal law. The heavy burden of proof (i.e. beyond a reasonable doubt) coupled with the requirement to establish that the merger was or was likely to be against the public interest made it next to impossible for the Attorney General to enforce antitrust law with respect to mergers. In two cases, Canadian Breweries

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The word merger was defined in section 2:

> "merger" means the acquisition by one or more persons, whether by purchase or lease of shares or assets or otherwise, of any control over or interest in the whole or part of the business of a competitor, supplier, customer or any other person, whereby competition
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> (a) in a trade, industry or profession,
> (b) among the sources of supply of a trade, industry or profession,
> (c) among the outlets for sales of a trade, industry or profession, or
> (d) otherwise than in paragraphs (a), (b) and (c),
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> is or is likely to be lessened to the detriment or against the interest of the public, whether consumers, producers or others;"

[162] Competition Law Amendments: A Guide, Minister of Consumers and Corporate Affairs (December 1985), p. 16.

[163] McFertridge, "The Emergence of a Canadian Merger Policy: The ERCO Case", (1974) Antitrust Bulletin 1; Funeral Homes Ltd. (Annual Report for the year ended March 31, 1988/D.I.R. Competition Act.)

and B.C. Sugar Refining, the courts refused to consider U.S. cases on mergers under section 7 of the Clayton Act because this section is governed by civil law whereas the Combines Investigation Act was a criminal statute[164].

The failure of prosecution is illustrated eloquently by the decision of the Supreme Court of Canada in The Queen v. K.C. Irving Ltd. et al.[165]. In 1944, K.C. Irving Ltd. took over the New Brunswick Publishing Company Ltd. which published two newspapers, the Telegraph Journal and The Evening Times-Globe. In turn, New Brunswick Publishing Company Ltd. in 1948 acquired the Moncton Publishing Company Limited, publisher of The Moncton Times and The Moncton Transcript. Between 1958 and 1971, K.C. Irving Limited completed three stock acquisitions that gave it control over all outstanding shares of University Press of New Brunswick Limited, the publisher of the Daily Gleaner. So by 1971, K.C. Irving Limited controlled every English daily newspaper in New Brunswick.

The Attorney General of Canada laid charges against K.C. Irving Limited and the newspapers involved under the monopoly and merger provisions of the Combines Investigation Act.

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[164] R. v. British Columbia Sugar Refining Company Limited et al., 32 W.W.R. 577, at 612; R. v. Canadian Breweries Ltd., [1960] O.R. 601, at pp. 622-24.

[165] [1978] 1 S.C.R. 408.

There were two separate indictments, one covering the period between 1948 and 1960 and another the period between 1960 and 1971. Under the second indictment, K.C. Irving was charged with having been party to the formation of an illegal merger because of the acquisition in 1958 of an additional 55% of the shares of University Press of New Brunswick Limited (it already owned 25%) and the acquisition of the remaining shares in 1971.

As to the illegal merger charge, the Court ruled that the Attorney General had not proved that the merger had or was likely to be against the public interest. More importantly, the Court decided that no prejudice could be inferred from the fact that K.C. Irving established a virtual monopoly over English newspapers in New Brunswick by acquiring competitors[166]. Chief Justice Laskin pointed out that apart from the acquisition of equity interest in competing newspapers, there was no evidence of anticompetitive behavior as in the case of R. v. Eddy Match Co. Ltd. This ruling amounted to a

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[166] Irving, supra, note 165, p. 425:

> "In the light of the definition of "merger" in the present Combines Investigation Act it is impossible to say that acquisition of entire control over a business in a market area (as contrasted with acquisition of some control) must mean without more not only that competition therein was or was likely to be lessened but that by reason of such control the lessening or likely is to the detriment or against the interest of the public."

judicial repeal of section 33, since the facts submitted before the trial court clearly demonstrated that the defendants had market power within the relevant market. Given the obvious monopolistic nature of the transactions described, it was clear that the Attorney General would never be able to get a conviction in a prosecution under section 33 of the Combines Investigation Act after this decision.

The Irving case became a serious obstacle to the enforcement of the merger provision. In 1985, the Attorney General of Canada attempted to prevent Fleet Aerospace Corporation from completing a takeover bid for the acquisition of the majority of the shares of Fathom Oceanology[167]. The Attorney General applied to the Federal Court of Canada for an interim injunction under section 29.1 of the Combines Investigation Act. The Court dismissed the application in part because it was not satisfied that the transaction was a merger within the meaning of the Act for, according to Mr. Justice Muldoon, Fleet and Fathom were only potential competitors. The Court mentioned that mergers were subject to criminal law and that the ruling of the Supreme Court in Irving applied in spite of the fact that the Attorney General was seeking an injunctive relief instead of a criminal conviction.

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[167] 5 C.P.R. (3d) 470.

2.4 Summary

The repeal of section 33 of the Combines Investigation Act; the test embodied in subsection 92(2) of the Competition Act which is identical to that embodied in section 7 of the Clayton Act; the establishment of a specialized tribunal for reviewing mergers which are now governed by the rules applicable to civil matters; the prenotification procedure; all indicate that the main intention of Parliament in enacting the new merger provisions was to make merger-review effective. In so doing, Parliament sent a clear message that horizontal mergers should be revised by according utmost importance to the legal and economic principles set by the U.S. judiciary. The Supreme Court of Canada ruled in the past that we can rely on U.S. antitrust cases to interpret our own legislation when specific aspects of competition law are regulated by similar statutory provisions[168].

Any construction of subsection 92(2) of the Competition Act placing market share and concentration on the same footing as any other factor with respect to horizontal mergers is incompatible with the objective of the Act. The structural characteristics of most factors listed in section 93 (i.e.

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[168] Weidman v. Shragge, [1912] S.C.R. 1 (p. 27); R. v. Eddy Match Co., 104 C.C.C. 39 (p. 74); General Motors of Canada Ltd. v. City National Leasing, [1989] 1 S.C.R. 641 (p. 668).

entry barriers, remaining competition, removal of an effective competitor, change and innovation)[169] and the requirement that the Tribunal proceeds "informally and expeditiously" on an application made by the Director[170], also militates in favour of a restrictive interpretation of subsection 92(2).

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[169] See Hunter, Lawson A.W., supra, note 131.

[170] Competition Tribunal Act, subsection 9(2).

CONCLUSION

In the foregoing pages we have suggested an interpretation to subsection 92(2) of the Competition Act. In our view this interpretation is consistent with the purpose and the merger provisions of the Competition Act. We also believe that the approach adopted by the U.S. Supreme Court in Philadelphia National Bank is suited for a country like Canada where the most important industries are oligopolistic. In that context, it is appropriate to rely on structural factors like indices of concentration and market shares to assess the likely anticompetitive impact of a horizontal merger, for marriages between leading competitors within oligopoly markets are most likely to lessen competition substantially.

The implementation of a prima facie rule of substantial lessening on competition towards horizontal mergers, based on market share and concentration, would not prevent Canadian firms from realizing economies of scale for two reasons. First, such rule would only apply where a merger involving two competitors increases substantially their market share as well as overall concentration in the industry. Hence, small firms wishing to merge in order to achieve minimum scale of efficiency would not be penalized. The rule would never prevent mergers likely to provide real efficiencies.

The other reason why a prima facie rule would not hinder mergers creating efficiencies is that market share and concentration must be evaluated with reference to a relevant market. Market definition is the most important stage in any antitrust case. If the market has a continental or international dimension foreign competitors are included so the market share of the merging firm is unlikely to trigger the application of the rule. Thus, a structural approach would not impede Canadian firms' competitiveness abroad. However, it would prevent domestic firms from acquiring market power in local, provincial and national markets. It must also be remembered that in every case defendants would be allowed to introduce countervailing evidence.

The argument in favor of a "tolerant" antitrust policy in the field of mergers and acquisitions in Canada is specious to say the least. The prevailing approach seems to be that in a small economy like Canada it is more costly to prevent a merger that would enhance efficiency than to allow an anticompetitive merger to proceed. This argument is without merit because it is always possible to realize efficiencies through internal growth although it may take more time to achieve. On the other hand, once a merger is completed, it is almost impossible to restore the prior condition of the market. Furthermore, deconcentration via new entry is less likely to occur in small economies than in large economies.

If we add that in Canada the effectiveness of antitrust law against price-fixing, especially tacit collusion, is far from being satisfactory, the reasoning referred to at the outset of this paragraph is unsupportable.

The interpretation to subsection 92(2) of the Competition Act advocated in this paper is not the sole construction consistent with the statute. However, the free-for-all analytical framework defended by the Director of Investigation and Research since the coming into force of the Competition Act is senseless and unworkable. It is somewhat ironic that such an unenforceable interpretation comes from regulators. The fact that the Director reads the merger provisions of the Act as imposing on him the Herculean task of proving each element listed in section 93 is a clear indication that regulators have no commitment to enforcing antitrust law against anti-competitive mergers.

The merger guidelines released by the Director recently are an exercise whereby regulators attempt to demonstrate that mergers are not justiciable. The Director has been able to impose his policy without challenge in large part because private litigants cannot have access to the Tribunal. In the United States "private attorney generals" have contributed to preserve the rule of law in spite of repeated attacks by the Reagan administration to cripple antitrust enforcement.

Ultimately, the scope of the merger provisions will have to be decided by the Competition Tribunal in a full and open debate where every intervenor have an opportunity to make representations. Unfortunately, the Director has the power to prevent such a debate from taking place. Yet, whether preventing private parties from applying to the Competition Tribunal for a remedial order is justifiable, in a free and democratic society governed by the rule of law, is a legal issue which can be debated before a Superior Court.

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APPENDIX A

Twice in the seventies oil crisis shook the Western economy. It provoked drastic changes in consumers' preferences for automobiles. As a result, demand for small fuel-efficient vehicles increased significantly. Japanese automobile manufacturers were already producing a lot of these cars so they increased their market share in North America. By the end of the seventies small cars had become an important submarket in the automobile industry. For the first time in the last fifty years competition had an opportunity to develop in a segment of the industry. This new development was not in the interest of the "Big Three" especially General Motors, a manufacturer involved mainly in manufacturing large cars.

In the United States and Canada the structural organization of the automobile industry is tightly oligopolistic. It is not exactly a model of superior competitive performance. The industry became oligopolistic because the "Big Three" – General Motors having played a major role – were involved in potentially anticompetitive behavior such as horizontal and vertical mergers and exclusive dealing, and unfair methods of competition like annual style change[1]. In 1966, attorneys in the Department of Justice (Antitrust Division) prepared a complaint and a memorandum of facts charging General Motors with monopolization of the automobile industry pursuant to section 2 of the Sherman Act and section 7 of the Clayton Act[2]. The Department of Justice even considered a "shared monopoly" complaint against General Motors, Ford and Chrysler[3].

Notwithstanding this background, in February 17, 1983, General Motors Corporation and Toyota Motors Corporation made public a Memorandum of Understanding for the establishment of a Joint Venture Corporation. It was a proposed manufacturing agreement whereby Toyota would produce a specific type of small car for General Motors at one of its closed facilities in Fremont, California. Under this supplier-customer agreement the vehicles manufactured would be sold by the Joint

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[1] NOTE, "Annual Style Change in the Automobile Industry as an Unfair Method of Competition", 80 Yale Law Journal 567 (1971).

[2] Green, Moore, Wasserstein, The CLOSED ENTERPRISE SYSTEM (Ralph Nader's Study Group Report on Antitrust Enforcement) Bantam Books (1972), pp. 250-51.

[3] Ibid., p. 252.

Venture to General Motors. The agreement provided for a 50-50% participation in the Joint Venture Corporation[4].

General Motors explained that it needed to enter into this cooperative arrangement in order to acquire Japanese technology for manufacturing small cars more efficiently. The Japanese vehicle to be manufactured by the Joint Venture was one over which Toyota held a patent. This justification is astonishing to say the least. General Motors, the world's largest car manufacturer with assets of $41 billion in 1982[5], confessed that Toyota (five times smaller with assets of $8.3 billion in 1982)[6] was a more effective producer of small cars in spite of its small size. One can legitimately speculate as to what would have been the state of competition in the automobile industry if the Department of Justice had enforced U.S. antitrust laws against General Motors in the sixties.

The joint venture was subject to approval by U.S. antitrust agencies pursuant to the prenotification procedure embodied in the Hart-Scott-Rodino Antitrust Improvement Act of 1976. On April 11, 1984 the Federal Trade Commission approved a consent order granting a green light to G.M. and Toyota for completing the joint venture subject to the restrictions of the order. Essentially the consent order contains restrictions as to the limitation period of the joint venture (i.e. 12 years), the number of vehicles to be produced annually (i.e. 250,000 annually) and the type of information that can be exchanged by the parties to achieve the objectives of the joint venture[7].

Three commissioners approved the consent order and two opposed it. The three commissioners in favour of the consent order, including Chairman James C. Miller III, were unable to refer to a single court decision to support their position. Miller endorsed the joint venture because it would supposedly lead to increase output for small cars; yield economies in producing small cars; and enable G.M. to learn how to produce price-competitive small cars. This, in turn, would increase

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[4] A copy of the Memorandum of Understanding is reproduced in F.T.C. v. General Motors Corporation et al., 103 F.T.C. 374.

[5] Fortune. May 2, 1983 (Special Number on the 500 U.S. Industrial Corporations).

[6] Fortune. August 22, 1983 (Special Number on the World's Largest Industrial Corporations).

[7] F.T.C. v. General Motors Corporations et al., 103 F.T.C. 374 (see Decision and Order).

competition between American and Japanese manufacturers he argued. The reasons of Chairman Miller is more an essay on what antitrust laws should be than "a careful application of antitrust principles to the specific facts at hands"[8].

The reasons of Commissioner Patricia Bailey are more instructive as to the real threat that the joint venture represents to future competition in the industry. At the outset Commissioner Bailey stressed that the ruling of the Commission in favour of the joint venture set a per se rule of legality for every type of joint venture. She referred also to the legal precedents applicable to decide the legality of joint ventures under section 7 of the U.S. Clayton Act. In accordance with these principles she concluded that the joint venture could not "be sanctioned under the antitrust laws"[9].

Her opposition to the joint venture stemmed from the fact that both G.M. and Toyota disposed of financial and technical resources that enable them to undertake most projects. Also, the automobile that the parties wanted to produce at the G.M.'s plant has no innovative feature: they did not expect to realize an important technological breakthrough. Finally, given the structure of the industry the joint venture would have permanent effect upon the level of rivalry among car manufacturers. This conclusion was based on two elements. First, the sensitive information that G.M. and Toyota would have to exchange in the course of the project would provide them with useful data about each other's competitive strategies in the market. Second, since the price of the car manufactured by the joint venture would be fixed by the parties, based on the price of similar models of competitors, there was a genuine risk that this experience would contribute to the emergence of a cartel – G.M. and Toyota being price leaders among U.S. and Japanese manufacturers respectively.

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[8] As dissenting Commissioner Bailey pointed out:

> "The decision for this Commission, however, is whether a joint venture such as that proposed by these companies is sanctioned by the nation's antitrust laws. I do not believe by any stretch of the imagination that it is. Whether it should be is not for me to say. The argument should be posed in another forum."

F.T.C. v. General Motors Corporation et al., 103 F.T.C. 374, at p. 392.

[9] Dissenting Statement of Commissioner Patricia P. Bailey, F.T.C. v. General Motors et al., 103 F.T.C. 374, at p. 391.

There was another dissenter: Chrysler Corporation. Soon after the F.T.C. had approved temporarily the consent order, Chrysler Corporation filed an antitrust suit against G.M. and Toyota on January 12, 1984. Chrysler sought to enjoin the joint venture to proceed on the ground that it violated section 7 of the Clayton Act, section 1 of the Sherman Act (conspiracy in restraint of trade) and section 2 of the Sherman Act (monopolization and attempt to monopolize)[10]. The complaint filed by Chrysler is quite enlightening with respect to the anticompetitive purposes pursued by G.M. and Toyota by entering into the joint venture.

In this complaint Chrysler alleged inter alia that in the years preceding the joint venture G.M. and Toyota were competing vigorously within the relevant market[11]. The joint venture would violate section 7 of the Clayton Act because it will weaken price competition not only between G.M. and Toyota but industrywide[12]. Furthermore, since G.M. would not have to invest the same amount of capital in the small car market segment as its competitors, it would be able to concentrate its resources in the large car segment and strengthen its dominant position therein[13]. The action of Chrysler[14]

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[10] Chrysler Corporation v. General Motors Corporation et al., Civil Action N° 84-0115 (U.S. District Court for the District of Columbia).

[11] Complaint (paragraph 34).

[12] Complaint. Sub-paragraph 35c reads in part:

"The joint venture will reduce price competition between GM and Toyota on one hand and other automobile manufacturers on the other. Under the pricing formula embodied in the Memorandum of Understanding, the price of the Sprinter will be determined in part by the price of subcompact automobiles of other manufacturers. This provides an immediate disincentive to other manufacturers to compete vigorously in price with the joint venture because price reductions by the other manufacturers will reduce the price of the Sprinter."

[13] Complaint. Sub-paragraph 35(f) reads in part:

"Moreover by allowing GM to avoid investment in small-car design the joint venture will permit GM to concentrate its expenditure of capital funds on the development of larger models, rendering its already dominant position in these markets virtually impregnable."

illustrates that the joint venture aimed at altering competitive behaviors of automobile manufacturers. It was not achieved to improve competitiveness but to lessen competition. Once again General Motors took the lead in assimilating competition as it had done in the United States with domestic competitors in the first half of the century. Today Ford and Chrysler are involved in joint ventures with foreign manufacturers and it is increasingly difficult to identify who competes with who[15].

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[14] The action was settled in April 1985 "Chrysler Settles Suit Over Link of GM, Toyota", Wall Street Journal, April 15, 1985.

[15] For a detailed description of the international links between automobile manufacturers, see Adams, Walter and Brock, "James W., "The New Learning and the Euthanasia of Antitrust", 74 California Law Review 1515 (1986), at 1534-35.

APPENDIX B

It was proposed in the Neal Report to strengthen section 7 of the Clayton Act to reach every type of conglomerate merger, prohibit exclusive patent licensing and modify the law as to price discrimination. But the most innovative proposal was with respect to oligopoly industries. The majority of the members of the Task Force concluded that there was a need for special legislation dealing exclusively with oligopoly industries since this type of market structure leads to supra competitive prices, output restriction and reduction of technical innovations[1]. Thus the Task Force proposed the enactment of complementary antitrust legislation, i.e. "The Concentrated Industries Act"[2]. Basically, the proposed Concentrated Industries Act aimed at breaking up oligopolistic industries in order to decrease the level of concentration and stimulate competition therein. The majority of the Task Force deemed that it was important not only to prevent market from becoming oligopolistic, but also to restore competition in those markets. To that end a Special Antitrust Court would have been empowered with jurisdiction to hear proceedings in equity to determine whether an industry is an oligopoly as defined in the proposed legislation.

The proposed legislation contained a complex definition of oligopolistic industry. It was defined with reference to the four-firm concentration ratio in the ten years preceding a legal action toward deconcentration. An industry would have been deemed to be oligopolistic if exhibiting a four-firm concentration ratio of at least 70% "during at least seven of the ten and four of the most recent five base years"[3]. Furthermore, the four-firm concentration ratio had to show a certain stability throughout the ten-year period. For the first half of the ten-year period immediately preceding the time of institution of proceedings, the four-firm

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[1] Report of the White House Task Force on Antitrust Policy; supra, note 25, p. 24.

[2] Reproduced in Appendix A of the Report of the White House Task Force on Antitrust Policy.

[3] (Appendix A of the Report of the White House Task Force on Antitrust Policy), Concentrated Industries Act, paragraph 4(a)(i).

concentration ratio had to amount to at least 80% of same for the second half of the said ten-year period[4].

Only a firm with a market share of more than 15% in at least two of the three years prior to antitrust action could have been cited as defendant[5]. The Special Antitrust Court would have had the authority to allow structural relief as well as jurisdiction to monitor a decree's effectiveness over the time. Yet, the special tribunal was not allowed to enter a decree enjoining a firm to divest assets that would deprive it of the minimum scale of efficiency. Nevertheless, the Concentrated Act as proposed was "no-fault" monopoly legislation, for there was no efficiency defense available to defendants[6].

Six out of the nine members of the Task Force endorsed the Concentrated Industries Act. Among the three dissenting members was Robert H. Bork now Circuit judge in the District of Columbia. The Concentrated Industries Act was never adopted by Congress essentially because former President Lyndon B. Johnson decided to retire after its first mandate. Otherwise the enactment of the Concentrated Industries Act would have been a legislative priority in its second mandate[7].

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[4] (Appendix A of the Report of the White House Task Force on Antitrust Policy), Concentrated Industries Act, paragraph 4(a)(ii).

[5] (Appendix A of the Report of the White House Task Force on Antitrust Policy), Concentrated Industries Act, subsection 4(6).

[6] In U.S. v. Grinnell Corp., 384 U.S. 563, the U.S. Supreme Court ruled that monopoly power which is the result of "growth or development as a consequence of a superior product, business acumen, or historic accident" do not contrevene section 2 of the Sherman Act creating a monopoly offence.

[7] Green, Moore, Wasserstein, "The Closed Enterprise System" (Ralph Nader's Study Group Report on Antitrust Enforcement), Bantam Book (1972), p. 310.

APPENDIX C

Here is a list of decisions wherein U.S. federal courts applied the prima facie test of illegality elaborated in U.S. v. Philadelphia National Bank in horizontal mergers cases litigated under section 7 of the Clayton Act, after the coming into force of the 1982 merger guidelines:

Christian Schmidt Brewing Company v. G. Heileman Brewing Company, 600 F. Supp. 1326.

Consolidated Gold Fields PLC v. Minorco S.A., 871 F. 2d 252.

Dome Stadium Hotel Inc. v. Holiday Inns Inc., 732 F. 2d 480 (1984).

F.T.C. v. Coca-Cola Co., 641 F. Supp. 1128.

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