



THE CANADIAN
BAR ASSOCIATION
L'ASSOCIATION DU
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Draft 2020 Vertical Merger Guidelines

**CANADIAN BAR ASSOCIATION
COMPETITION LAW SECTION**

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PREFACE

The Canadian Bar Association is a national association representing 36,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the Competition Law Section, with assistance from the Advocacy Department at the CBA office. The submission has been reviewed by the Law Reform Subcommittee and approved as a public statement of the Competition Law Section.

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Draft 2020 Vertical Merger Guidelines

I. INTRODUCTION

The Competition Law Section of the Canadian Bar Association (CBA Section) welcomes the opportunity to comment on the U.S. Department of Justice Antitrust Division's and Federal Trade Commission's (collectively, the Agencies) draft 2020 Vertical Merger Guidelines (Vertical Merger Guidelines). We commend the Agencies' continuing efforts to engage with stakeholders through meaningful consultations.

The CBA Section takes a special interest in the Vertical Merger Guidelines because of their potential significant impact on merger reviews involving Canadian businesses that are vertically integrated in the U.S and how the Canadian Competition Bureau assesses vertical mergers going forward.

II. COMMENTS

A. Section 2: Definition of Related Products is Vague

The Vertical Merger Guidelines state "the Agencies will normally identify one or more relevant markets in which the merger may substantially lessen competition"¹ and the Agencies "will also specify one or more related products".² The concept of "related" raises several issues. For example, what degree of "relatedness" is required and how will it be determined?

In addition, a vertical relationship between a relevant market and related product does not necessarily mean that the related product can exert a competitive effect on the relevant market. The Vertical Merger Guidelines do not elaborate on how to determine whether the linkage between a relevant market and related product is competitively significant.

Finally, the Agencies contemplate that a related product could be "a means of distribution, or access to a set of customers". These are not products at all, although these factors could be pertinent to the competitive analysis.

¹ Vertical Merger Guidelines at 2.

² *Id.*

RECOMMENDATION

- 1. We recommend that the Vertical Merger Guidelines clarify: (a) what level of detail is typically required in evaluating the related product; (b) if (or when) there are situations where a full relevant market definition is needed for the related product; and (c) how non-products can also form part of the analysis.**

B. Section 3: 20% Safe-Harbour Threshold Too Low

A merged firm generally does not have the ability to engage in anti-competitive foreclosure if it does not have some degree of market power in at least one of the downstream or upstream markets. By any comparison, the proposed 20% relevant market/20% related product market share safe-harbour threshold is quite low as a proxy for the lack of requisite market power for engaging in foreclosure.

It is also inconsistent with recent U.S. case law. For example, in *AT&T/Time Warner*, the U.S. Department of Justice Antitrust Division alleged that AT&T/DirectTV was the “largest participant in [the multichannel video programming distributor] product market in the United States”³ and “has more than 40 percent of MVPD subscribers in at least 18 local Designated Market Areas”.⁴ Despite these shares, neither the district court nor the court of appeals found that substantial anti-competitive effects were likely. Similarly, the screens for vertical mergers used in other jurisdictions around the world are higher, including the EU (30%), Japan (35%), France (30%), Brazil (30%) and China (25%). Of relevance to the CBA Section is Canada’s 35% threshold, which is applicable to both horizontal and vertical mergers.

RECOMMENDATION

- 2. We recommend using a higher market share screen for the relevant product market and related products (to align the U.S. with other jurisdictions, not to mention its own case law).**

C. Section 3: Make the Safe-Harbour Threshold More Meaningful

The Vertical Merger Guidelines identify and then effectively undercut the proposed 20% relevant market/related product market share threshold. Specifically, the Vertical Merger Guidelines state “[t]he purpose of these thresholds is not to provide a rigid screen to separate

³ Complaint, *U.S. v. AT&T Inc.*, Case No. 1:17-cv-02511, at paragraph 28 (D.D.C. Nov. 20, 2017), available online at www.justice.gov/atr/case-document/file/1012916/download.

⁴ *Id.*

competitively benign mergers from anti-competitive ones. Rather, they provide one way to identify some mergers unlikely to raise competitive concerns and some others for which it is particularly important to examine other competitive factors to arrive at a determination of likely competitive effects.”⁵ This qualification appears to negate the value of the market share screen by saying that the safe-harbour threshold may not really be a safe harbour at all.

In a similar vein, the Vertical Merger Guidelines state “[t]he Agencies are unlikely to *challenge* a vertical merger” (emphasis added) that is below the 20% safe-harbour threshold.⁶ The purpose of a safe-harbour should also be to give the merging parties comfort that the Agencies would not extensively investigate these cases. The implication is that below-threshold vertical mergers could still face extensive review, even though a challenge would be unlikely, thereby risking the unnecessary expenditure of significant resources.

RECOMMENDATION

- 3. We recommend that the Vertical Merger Guidelines: (a) delineate the circumstances where the Agencies are likely to deviate from the 20% screen; and (b) indicate that the Agencies “are unlikely to challenge *or extensively investigate*” a vertical merger where the safe-harbour threshold is not exceeded.**

D. Section 5: Both Ability and Incentive Must be Present

The Vertical Merger Guidelines appear to suggest that it would be sufficient for the Agencies to show that the merged firm had either the incentive or the ability to engage in anti-competitive conduct. For example, Section 5(a) states “the merger may increase the incentive or ability of the merged firm to raise its rivals’ costs or decrease the quality of their rivals’ products or services”.⁷ However, by definition, both *incentive* and *ability* must be present for a merged firm to engage in anti-competitive conduct.

RECOMMENDATION

- 4. We recommend that the Vertical Merger Guidelines clarify that both the incentive and ability to engage in exclusionary conduct are required to raise competition concerns. This would be consistent with the Agencies’ other guidance documents, such as the Horizontal Merger Guidelines, which recognize that both incentive**

⁵ Vertical Merger Guidelines at 3.

⁶ *Id.*

⁷ *Id.* at 5.

and ability are required.⁸ The Canadian Competition Bureau’s Merger Enforcement Guidelines also recognize that both incentive and ability must exist in order for anti-competitive effects to occur.⁹

E. Section 5: What about Customer Foreclosure?

The Vertical Merger Guidelines define “foreclosure” as input foreclosure (i.e., the merged firm refusing to sell inputs to its downstream rivals), without mentioning anything about customer foreclosure (i.e., the merged firm refusing to purchase inputs from its upstream rivals).

Similarly, the Vertical Merger Guidelines discuss raising rivals’ costs (i.e., partial input foreclosure), without addressing the creation of monopsony power (i.e., partial customer foreclosure). This leaves a hole in the Vertical Merger Guidelines where no guidance is given.

Presumably, the Agencies would challenge a vertical merger based on (partial) customer foreclosure concerns.

RECOMMENDATION

- 5. We recommend that the Vertical Merger Guidelines add discussion and examples of (partial) customer foreclosure.**

F. Section 6: Merging is Necessary to Eliminate Double Marginalization

The Vertical Merger Guidelines state “[t]he effects of the elimination of double marginalization may be lower if, prior to the merger, the merging parties already engaged in contracting that aligned their incentives, for example by using a two-part tariff with a fixed fee and low unit prices that incorporate no, or a small, margin”.¹⁰

While non-linear prices or quantity-forcing contracts can lessen the impact of double marginalization to a certain extent, a merger is the only realistic and practical way to eliminate double marginalization, with the possible exception of metal-neutral joint ventures in the airline industry. It is simply not realistic that arm’s length parties could sufficiently align their incentives to eliminate double marginalization. Contractual negotiation is also costly, complex, and time consuming and generally not feasible to cover all aspects of future performance.

⁸ See, for example, Horizontal Merger Guidelines at Sections 2.15, 5.2 and 6.2, available [online](#).

⁹ Competition Bureau, Merger Enforcement Guidelines at paragraph 11.8, available [online](#).

¹⁰ Vertical Merger Guidelines at 7.

RECOMMENDATION

- 6. We recommend that the Vertical Merger Guidelines: (a) recognize the difficulties that arise in attempting to eliminate double marginalization and other efficiencies through contracting as an alternative to vertical integration; and (b) explicitly state that a pre-existing contract will not be treated as conclusive evidence that vertical integration is unnecessary and, rather, could be evidence to the contrary.**

G. Section 8: Specify Types of Potential Efficiencies

It is helpful that the Vertical Merger Guidelines state “because vertical mergers combine complementary economic functions and eliminate contracting frictions, they have the potential to create cognizable efficiencies that benefit competition and consumers”.¹¹ However, the Agencies could be more specific about the types of efficiencies that are most likely to be cognizable in vertical mergers.

RECOMMENDATION

- 7. We recommend that the Vertical Merger Guidelines refer to other types of efficiencies that can be achieved from vertical mergers, such as quality improvements and increased innovation arising from coordination in product and R&D efforts.**

H. Further Guidance on Remedies

The Vertical Merger Guidelines do not give any indication on whether the Agencies would consider behavioural remedies to address vertical concerns or would prefer structural remedies in vertical mergers, as is the case in horizontal mergers. In our experience, behavioural remedies are generally adequate to address vertical concerns. For example, vertical foreclosure concerns may be readily addressed through contractual commitments for long-term supply, while concerns about access to competitively-sensitive information may be effectively addressed through information firewalls.

¹¹ *Id.* at 9.

RECOMMENDATION

- 8. We recommend that the Vertical Merger Guidelines give further guidance on the situations where the Agencies would consider behavioural remedies as opposed to structural remedies in the context of vertical mergers.**

III. CONCLUSION

The CBA Section appreciates the opportunity to comment on the Vertical Merger Guidelines. We would be pleased to discuss our comments in more detail.

IV. SUMMARY OF RECOMMENDATIONS

The CBA Section recommends that:

- 1. Vertical Merger Guidelines clarify: (a) what level of detail is typically required in evaluating the related product; (b) if (or when) there are situations where a full relevant market definition is needed for the related product; and (c) how non-products can also form part of the analysis.**
- 2. a higher market share screen be used for the relevant product market and related products (to align the U.S. with other jurisdictions and its own case law).**
- 3. Vertical Merger Guidelines: (a) delineate the circumstances where the Agencies are likely to deviate from the 20% screen; and (b) indicate that the Agencies “are unlikely to challenge *or extensively investigate*” a vertical merger where the safe-harbour threshold is not exceeded.**
- 4. Vertical Merger Guidelines clarify that both the incentive and ability to engage in exclusionary conduct are required to raise competition concerns.**
- 5. Vertical Merger Guidelines add discussion and examples of (partial) customer foreclosure.**
- 6. Vertical Merger Guidelines: (a) recognize the difficulties that arise in attempting to eliminate double marginalization and other efficiencies through contracting as an alternative to vertical integration; and (b) explicitly state that a pre-existing contract will not be treated as**

conclusive evidence that vertical integration is unnecessary and, rather, could be evidence to the contrary

- 7. Vertical Merger Guidelines refer to other types of efficiencies that can be achieved from vertical mergers, such as quality improvements and increased innovation arising from coordination in product and R&D efforts.**
- 8. Vertical Merger Guidelines give further guidance on the situations where the Agencies would consider behavioural remedies as opposed to structural remedies in the context of vertical mergers.**