Canadian competition tribunal refuses to apply U.S. horizontal merger guidelines

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Summary

On Oct. 31, 2022, the Canadian Competition Tribunal (the Tribunal) issued a rare merger litigation decision[1] in ***Canada (Commissioner of Competition) v Parrish & Heimbecker, Limited*** **(CT-2019-005).**

The Tribunal dismissed the application to unwind a merger brought by the Commissioner of Competition (the Commissioner) under section 92 of the *Competition Act* (the Act), concluding that the Commissioner did not prove that the acquisition of a grain elevator near Virden, Manitoba by Parrish & Heimbecker, Limited (P&H) would lessen competition substantially in the markets for the purchase of wheat and canola in the area around the elevator.

Key to the decision was the Tribunal's refusal to apply an approach to relevant product market definition advanced in the U.S. Horizontal Merger Guidelines that the Commissioner had urged the Tribunal to adopt.

In this article, we provide a summary of the main arguments advanced by the Commissioner and P&H in regard to the relevant product market and the Tribunal's conclusions.

The acquisition

P&H, a family-owned Canadian agribusiness headquartered in Winnipeg Manitoba, acquired 10 primary grain elevators (Elevators) from Louis Dreyfus Company Canada ULC (LDC) in September 2019 and closed the deal in December 2019[2] (the Acquisition). The Commissioner challenged the Acquisition by P&H of one of these Elevators located on the Trans-Canada Highway in Virden, Manitoba (the Virden Elevator).

In his application challenging the Acquisition, the Commissioner claimed that the Acquisition was likely to cause a substantial lessening of competition in the supply of grain handling services (GHS) for wheat and canola for those farms that, the

Commissioner posited, benefited from competition between the Virden Elevator and a nearby elevator owned by P&H located in Moosomin, Saskatchewan (Moosomin Elevator).

Relevant product market: Purchase of wheat and canola or supply of grain handling services?

As the Tribunal noted in its summary of the ruling, the "definition of the relevant product market was a fundamental point of disagreement between the parties" that "significantly influenced many elements in the Tribunal's overall analysis". On his part, the Commissioner argued that the relevant product market was the supply of GHS, which according to the Commissioner includes: the "intermediary services" of elevation, grading, and segregation of the grain as well as cleaning, drying, blending and storage offered by the grain Elevators.[3]

In his closing arguments, the Commissioner contended that the approach of defining the provision of intermediary services as the relevant product market was supported by jurisprudence from Canada, the United States, and the European Commission,[4] noting in particular that the U.S. Horizontal Merger Guidelines (the U.S. HMGs)[5] "contemplate that the benchmark price used for analyzing product market can be different than the explicit price where the firms' specific contributions to value can be identified with reasonable clarity."[6] The Commissioner therefore argued that this "value-added" approach contemplated in the U.S. HMGs be applied in this case.

In response, P&H asserted that the relevant product market was the purchase of wheat or canola, and that there was no evidence that farmers and grain companies conduct their transactions on the basis of the sale and purchase of GHS. In particular, P&H, quoting the Competition Bureau's Merger Enforcement Guidelines (the MEGS)[7], noted that the base price used to postulate a price increase is typically the prevailing price in the relevant market, which is whatever is ordinarily considered to be the price of the product in the sector of the industry being examined.[8]

Further, P&H added that a review of the evolution of the MEGs confirmed a deliberate and "considered" abandonment of the 1991 MEGS that had adopted a "value-added" approach".[9] P&H noted that while a "value-added" approach was introduced into the revised U.S. HMGs issued in August 2010, the Commissioner did not include the "value-added" approach in either the draft or final versions of the revised MEGS published in October 2011. Moreover, P&H argued, even if one were to consider the U.S. HMGs approach in Canadian merger reviews (a point P&H did not concede), the U.S. HMGs expressly require that, in order to base a small but significant non-transitory increase in price (SSNIP) on an implicit price, the merging firms' specific contribution to value need to be identified with "**reasonable clarity**".[10] This condition was not met on the facts of the case.

P&H noted that the 1991 MEGS in fact referred to the general principle that the base price that is employed in postulating a SSNIP is "whatever is ordinarily considered to be the price of the product at the stage of the industry … being examined" which is "typically the cumulative value of the product, inclusive of the value added (mark-up) at the industry level in question." This meant, according to P&H, applying the transaction price between farms and companies as the base price.[11] P&H further pressed that the

1991 MEGs referred to the "value-added" approach as an “exception” to the general principle that would apply only in limited circumstances if “**the value added is billed as a separate fee, and no-mark-up is applied to the product in relation to which the service (or other value added) is performed**.”[12]

P&H pointed out that these conditions were not met on the facts of the case because the Commissioner was asking the Tribunal to use a base price for market definition that was founded on an *imputed price* equal to only a fraction of the total value added provided by the grain companies. Further, P&H recounted that: there was no separate fee for the alleged value added provided by the grain companies; farmers and grain companies do not transact business on the basis of the sale and purchase of GHS, and; any value-add by the grain companies to get the grain to export markets occurs *after* the purchase transaction with farmers.[13]

P&H further submitted that there were no precedents in Canada of a court or the Tribunal utilizing an implicit price for the merging firms’ specific contribution to the value of a product to determine the SSNIP and relevant market. P&H noted that while the approach had been advanced in a handful of cases in the EU, the US and Australia, the approach had either been rejected outright, or applied to facts that were distinguishable.

In addition, P&H stressed that the 5% SSNIP threshold used by the Commissioner’s expert, Dr. Miller, in his HMT analysis based on the imputed price of GHS translated into an **unprecedentedly low SSNIP** level when transposed to the price that farmers receive for their grain (the Cash Price). P&H demonstrated that in this case, utilizing the “value-added” approach of the Commissioner meant that the equivalent SSNIP percentage calculated by Dr. Miller varied between **0.6 per cent and 0.8 per cent** for the purchase of wheat when expressed in terms of the Cash Price that farmers receive for their wheat, and between **0.1 per cent and 0.2 per cent** for the purchase of canola. P&H therefore urged the Tribunal to decline the invitation to adopt the “value-added” approach.

The Tribunal’s decision

The Tribunal, in its decision[14], noted that it had concluded that the relevant product was not the sale of GHS to farms, as alleged by the Commissioner, but the purchase of wheat and canola, as advanced by P&H. The Tribunal held that the Commissioner’s proposed product market, the sale of GHS, “was not grounded in commercial reality and in the evidence.” In particular, the Tribunal agreed with P&H that for a product to exist in the economic sense and in the context of the relevant market definition for the purpose of an application under section 92 of the Act, there must be a separate and identifiable demand for it:

> “in order to apply the HMT, a relevant price for the relevant product must be identified. The focus is on the price of the good or service effectively being sold or bought. There can be no product, and no price for such product, if the product has no independent existence and market presence. The Tribunal further accepts P&H’s view that an article or a service which would be neither bought nor sold cannot fall within the definition of a “business” under the Act (and hence, the definition of a merger in section 91), because it would not be a product that is acquired, supplied, or otherwise dealt in.”[15]

Additionally, the Tribunal held that the "value-added" approach to product market definition proposed by the Commissioner "failed on the facts, from a precedential and legal standpoint, and from a conceptual and economic perspective", and thus refused to apply the approach outlined in the U.S. HMGs.

The Tribunal agreed with P&H that applying a 5 per cent price increase as part of the SSNIP test **only to the value-added portion** of the price of a product would effectively alter the price change that a hypothetical monopolist must be able to sustain, and that such as an alteration to the HMT, "would have the effect of seriously modifying the current well-accepted economic analysis underlying market definition and the HMT framework"[16]. The Tribunal held that adopting the Commissioner's approach would "imprint a profound change" to merger review and significantly recalibrate the current HMT framework governing the market definition exercise:

> **[350]** The Tribunal is not convinced that in the circumstances of this case, the Commissioner has provided clear and convincing evidence, or arguments, supporting such a fundamental change to the market definition exercise. The Commissioner provided no submissions nor evidence on what the appropriate SSNIP threshold should be in the context of his "value-added" approach, or why it should nonetheless be kept at 5% when a smaller component of the final price is used as the base price. The Commissioner's position simply assumed that the usual 5% SSNIP threshold should remain, and he applied it in the HMT analysis. These gaps in the conceptual framework undermine the approach he is proposing in this case…
>
> [353] The Tribunal is unaware of any precedent — and the Commissioner has not mentioned any— where a price increase of less than 5% has been utilized as the SSNIP threshold in applying the HMT analysis. **The Tribunal finds that the "value-added" approach as proposed would profoundly change the current HMT framework, and it is not ready to accept that minimal price increases of less than 1% can become the yardstick to justify an intervention in the market.** Lower effective SSNIP thresholds lead to narrower product markets, and to a higher likelihood of intervention in mergers.[17]

With regards to the geographic market, P&H had argued that the market was broader than that proposed by the Commissioner, noting that Elevators purchased grain from farms farther away than what the Commissioner alleged. The Tribunal agreed with P&H and found that the relevant geographic market for wheat and canola comprised **at least seven and ten Elevators, respectively, for** wheat and canola, as well as four canola crushing plants.

After considering the extensive economic and factual evidence tendered in the case, the Tribunal ultimately concluded that the Commissioner had not established that the Acquisition lessened, or was likely to lessen competition substantially in any relevant market. The Tribunal found that the evidence established that the price effects of the Acquisition were immaterial, that several effective remaining competitors remained after the Acquisition, and that post-merger market shares were below the 35 per cent safe harbor threshold.

While the Tribunal did not need to determine the efficiencies issue put to it by the parties in light of its conclusions above, the Tribunal nevertheless noted that P&H would not have met its burden of demonstrating, on a balance of probabilities, that the claimed gains in efficiency would be greater than, and would offset the anti-competitive effects of any lessening of competition resulting from the merger.

Conclusions

This case, among other things, demonstrates the importance of properly defining the relevant product market. While the U.S. HMGs expressly contemplate the potential use of a “value-added” approach in defining relevant product markets, the Canadian MEGs provide that “the base price used to postulate a price increase is whatever is ordinarily considered to be the price of the product in the sector of the industry…being examined.” Further, as P&H noted, and as the Tribunal accepted, the "value-added" approach to product market definition was not supportable by the facts or legal precedents. While the concept was argued in a handful of cases in the EU, the U.S. and Australia, it was explicitly rejected (such as in the *Metcash*[18] case), or applied to facts completely different from those in the present case.

The "value-added" approach also portends further risks to market definition, including imposing stricter merger analysis criteria than established in the MEGs and legal precedents, and introducing an undesirable degree of uncertainty and unintended consequences for merger law in Canada. As some antitrust economists have noted, applying the hypothetical monopolist test using the "value-added" approach tends to “produce more narrowly defined markets whenever the threshold used for the value added test is not sufficiently increased to account for the ratio of value added to prices.”[19]

For example, in *Metcash,* the Federal Court of Australia did not accept the use of the "value-added" approach because applying a 5 per cent SSNIP to the imputed value-added price (wholesaler profit margin in that case) would reflect just a **~0.26 per cent final retail price increase**. The Australian court did not accept that such a small increase could be used to define a product market and refused the "value-added" approach.

Using the "value-added" approach in this case would have produced similar results that would have effectively changed the SSNIP test from 5 per cent to less than 1 per cent. Such an approach would be unprecedented and would impose unusually low intervention thresholds that is not in accordance with the MEGs and the legal precedents.

Rob Russell, Denes Rothschild, and Joshua Abaki acted for P&H in the matter.

Footnotes

[1] The Tribunal issued a summary of its decision on October 31, 2022 (Decision Summary) and the full reasons on Nov 17, 2022. This article has been updated to incorporate some comments from the Tribunal’s full reasons.

[2] The parties closed the transaction on December 10, 2019, 32 days after submitting responses to the Competition Bureau's supplementary information requests (SIR).

[3] Notice of Application of the Commissioner of Competition, CT 2019-005, Doc # 2 at para 1.

[4] Closing Arguments of the Commissioner of Competition, CT-2019-005, Doc #234 at paras 63 and 71.

[5] U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, August, 19, 2010.

[6] Closing Arguments of the Commissioner of Competition, CT-2019-005, Doc # 234 at para 76-81.

[7] Competition Bureau, *Merger Enforcement Guidelines* (2011).

[8] P&H Closing Arguments, CT-2019-005, Doc # 238 at para 52.

[9] P&H Submissions on the 1991 MEGs, CT-2019-005, Doc #259 at para 6.

[10] P&H Closing Arguments, CT-2019-005, Doc # 238 at para 63.

[11] P&H Submissions on the 1991 MEGs, CT-2019-005, Doc #259 at para 1.

[12] P&H Closing Arguments, CT-2019-005, Doc # 238 at para 63

[13] P&H Submissions on the 1991 MEGs, CT-2019-005, Doc #259 at para 4.

[14] *Canada (Commissioner of Competition) v Parrish & Heimbecker, Limited*, 2022 Comp Trib 18 (P&H Decision)

[15] P&H Decision at para 236.

[16] P&H Decision at para 347.

[17] P&H Decision at paras 350-353.

[18] *Australian Competition and Consumer Commission v Metcash Trading Limited* [2011] FCA 967 [*Metcash*].

[19] P Davis and U Haegler, "*Should competition agencies focus on `value added' instead of final prices?*", March 1, 2016.

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