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LD/DS/DM/AG/PH

May 20, 2004

The Competition Bureau  
Place du Portage I,  
50 rue Victoria  
Gatineau, Quebec  
K1A 0C9

Attention: Lourdes DaCosta

Dear Ms. DaCosta:

The Forest Products Association of Canada (FPAC) is pleased to submit, on behalf of its members, comments on the Draft Merger Enforcement Guidelines ("Draft MEGs").

Facing an increasingly encompassing global marketplace, most Canadian forest products companies are today dealing with the challenges of intense international competition. The Canadian industry is more fragmented than its main international competitors, and Canadian firms are small by international standards. In this environment, an important competitive strategy is to consolidate in order to achieve greater efficiencies in production, marketing and access to capital. Therefore, a well-constructed merger review process is essential to the industry.

With that perspective, FPAC would like to express its appreciation for the opportunity to comment on the Draft MEGs. In our view, they represent a positive step in ensuring that the merger review process is both transparent and understood by merger proponents. We hope that these comments will be useful in highlighting some areas where further analysis and clarification could be helpful.

Yours truly,

Avrim Lazar  
President and Chief Executive Officer  
Forest Products Association of Canada

## **Comments on the Draft Merger Enforcement Guidelines released March 25, 2004**

### **Submission by the Forest Products Association of Canada (FPAC)**

#### **Introduction**

The Forest Products Association of Canada (FPAC) is pleased to provide comments on the Draft Merger Enforcement Guidelines (Draft MEGs), released on March 25, 2004.

FPAC is the voice of Canada's wood, pulp and paper producers nationally and internationally in government, trade and environmental affairs. FPAC provides an active forum for advancing ideas and issues of key importance to the Canadian forest products industry and the 350 communities it sustains across the country. FPAC includes Canada's largest producers of pulp, paper and wood products, and its members have responsibility for over 75 percent of the working forests in Canada.

Comprising 3% of GDP, the forestry sector has a significant interest in the future of competition policy and its implementation. Facing an increasingly encompassing global marketplace, most Canadian companies are today dealing with the challenges of intense international competition. The Canadian industry is more fragmented than its main international competitors, and Canadian firms are small by international standards. In this environment, an important competitive strategy is to consolidate in order to achieve greater efficiencies in production, marketing and access to capital. Therefore, a well-constructed merger review process is essential to the industry.

There is no question that Canada is a small open economy. In fact, 40% of Canada's gross domestic product (GDP) is generated from exports – four times the export dependence of the United States. Exports are the life-blood of so many Canadian industries. The forest products industry is an excellent example exporting 80% of production in the form of some 250 products to over 175 countries around the world.

This fundamental economic characteristic affects almost every facet of the Canadian economy and should be reflected in Canada's approach to implementing competition policy. Canada requires an approach that recognizes its role in an increasingly integrated North American and global market. This requires an ability to accurately assess the nature of markets in the post-NAFTA context and an openness to the benefits from efficiency-enhancing mergers and higher industrial concentrations in a small open economy.

With that perspective, FPAC would like to express its appreciation for the opportunity to comment on the Draft MEGs. In our view, they represent a positive step in ensuring that the merger review process is both transparent and understood by merger proponents. We hope that these comments will be useful in highlighting some areas where further analysis and clarification could be helpful.

For the purposes of this submission, we have made our comments in the numerical sequence set out in the Draft MEGs. We have made no further reference to those provisions in the Draft MEGs upon which we have no comment.

## **Part 2 – The Anti-Competitive Threshold**

### **Section 2.2:**

The MEGs quite properly assess market power from the perspective of a seller. FPAC believes it important to emphasize that productive capacity is not the same thing as market power. A concentration of productive capacity in a given geographic area does not imply that the producer would have market power. This is particularly true in all Canadian resource industries.

Consequently, FPAC suggests that there be added to Section 2.2 a sentence to state:

“A concentration of productive capacity does not, by itself, indicate the presence of market power.”

### **Section 2.13:**

The text of footnote 24 indicates that: “The Bureau may challenge a merger even when the anti-competitive effects that are foreseeable at the time of the merger may not occur until two years of when the merger is substantially completed”. This provision would appear to introduce an element of uncertainty, and could extend the entire period for analysis significantly.

Consequently, it might be appropriate for the Bureau to provide greater clarity on the particular circumstances in which the Bureau might perceive a substantial lessening of competition (“SLC”) which would not be apparent until after two years. FPAC has not been able to hypothesize such a circumstance.

## **Part 3 – Market Definition**

### **Section 3.3**

The provision does refer to supply responses, but only with respect to the modification of market power. Elsewhere in the Draft MEGs supply responses are recognized as assisting in the definition of the market itself – see, for example, Section 3.6.

FPAC therefore suggests amending Section 3.3 to provide:

“Supply responses are also important when analysing market power, and also in identifying the market itself, but are examined later in the analysis...”

It might also be appropriate to identify, by footnote, where that subsequent analysis takes place.

**Section 3.8:**

The Draft MEGs provide that “the base price used to postulate a price increase is whatever is ordinarily considered to be the price of the product at the stage of the industry ... being examined.” FPAC agrees with this statement but would draw attention to the fact that, in commerce, the price is that which is agreed between the buyer and the seller. Thus, in the sale of paper, the commodity price published by market reporters such as Resource Information Systems Inc. (RISI) are prices which include the cost of transportation from the mill to the buyer. Therefore, the price to the buyer is the delivered price. It is therefore this delivered price which should be the basis for examining possible price increases.

This section might therefore include a provision that:

“Where the ordinarily considered price includes freight, it is the delivered price which is to be considered.”

**Section 3.17:**

In the forest products industry, switching costs are unlikely to be a factor. The obvious reason is that purchasers characteristically buy product from more than one producer. It might therefore be desirable to add to the Draft MEGs the provision that:

“An indication that switching costs amongst suppliers are not high is where buyers currently purchase from multiple suppliers.”

**Section 3.19:**

This provision correctly stresses that it is buyers’ response that is determinative. In order that it be quite clear that the buyer is the critical element, we suggest an amendment to this section so that it reads:

“for purposes of geographic market definition, what matters is not the identity or geographic concentration of the suppliers but buyer’s ability ...”

In addition, the notion of “willingness” implies a subjectivity on the part of the buyer that could be unrelated to their ability to switch their purchases, and we recommend that it be dropped from this section and the focus be on ability to switch. This is also relevant to Sections 3.27 and 3.28, which concern foreign competition.

**Section 3.20:**

We believe that there is further and frequently better evidence to define geographic market than “indirect evidence of substitutability including evidence from market participants and the

functional indicators described below”. These are valuable indicators of geographic market, but we also believe strongly that statistical and rigorous economic analysis can accurately delineate geographic markets. All too frequently market participants have a discernable self interest while statistical work and economic analysis, properly conducted, do not.

We would therefore suggest that section 3.20 be amended to add reference to statistical and economic analysis as bases upon which the Bureau will rely in identifying geographic markets.

### **Section 3.26:**

In identifying that shipments of the relevant product from a more distant area into an area may suggest that both areas are in the same relevant market, we believe that the Draft MEGs are more tentative than is, in fact, the reality. If shipments are truly significant from distant areas to a local area then the distant area is very likely part of the relevant geographic market. At the same time, the potential shipment from distant suppliers can have a constraining effect on price.

We therefore suggest that two changes be considered:

- (i) provide clear indication that where there are *significant* shipments from the distant area to the local area, then the distant area is likely part of the relevant geographic market that includes the local area; and
- (ii) indicate that the lack of shipment from the distant area to the local area does not establish that the distant area is not part of the relevant market because, as the Draft MEGs state, “pre-merger shipment patterns do not, by themselves, establish the constraining effect of distant suppliers.”

For FPAC this is an extremely important matter. FPAC sees constant evidence of distant suppliers entering new geographic areas when price or currency differentials encourage such entry. This pattern is in fact recognized by the Draft MEGs in Section 3.28.

## **Part 4 – Market Share and Concentration**

### **Section 4.3:**

In FPAC’s view, the discussion of relevant factors for assessing whether foreign suppliers do or could participate in the relevant market appears to take an overly negative view of the constraints to participating in the Canadian market, particularly for trade with the U.S. In practice, there are no tariffs between Canada and the U.S., firms regularly hedge against currency fluctuations, labelling is rarely an issue, it often takes little time and effort to become familiar with the Canadian market, and there are few difficulties associated with customs and processing imports.

FPAC believes that a more neutral statement of factors, which eliminates those that are rarely barriers or which are adequately assessed elsewhere in the review process would be preferable. In addition, a positive statement might well be made with respect to foreign suppliers to the effect that, in commodity businesses, there are unlikely to be any barriers to foreign suppliers other than freight and currency costs.

## **Sections 4.9-4.11**

When calculating market shares it is important to adequately recognize all suppliers. Sections 4.9-4.11 appear to create an unbalanced treatment in which market shares of suppliers from outside the relevant market are discounted. The resulting understatement is acknowledged in Section 4.12. A better approach may be to calculate shares on the same basis as for other market participants and if these are based on capacity or reserves then include only the capacity or reserves that are likely to be available from distant suppliers to the relevant market in the event of a price increase. This would track the treatment of firms that participate through a supply response as described in paragraph 4.11. If the above cannot be achieved, FPAC encourages the Bureau to further recognize this potential understatement by indicating efforts to balance it in the Bureau's analysis.

## **Part 5 – Anti-Competitive Effects**

### **Section 5.4**

An interesting point is raised here. In industries that are stable or contracting it is not necessarily the case that if the merging parties hold a significant share of excess capacity in the relevant market, expansion by rivals will be discouraged. Through merger there might well be a reduction in overall capacity, a consequent increase in efficiency, and a direct benefit to consumers. The fact that the merger will have removed capacity also removes the threat of excess capacity to a rival. FPAC believes that the Draft MEGs should also postulate this scenario.

### **Section 5.11:**

This section appears correct but perhaps somewhat incomplete. Even if some demand is diverted to a firm's merger partner this need not make it profitable for the merged firm to raise price, as buyers may be able to turn, in sufficient numbers, to other suppliers within the market and also to potential suppliers who may enter the market such that the merged firm will not find it profitable to raise price.

### **Section 5.13:**

FPAC believes this Section to be accurate but limited to firms that produce differentiated products.

### **Section 5.21:**

Because of the market structure in commodity industries, certain of the "facilitating factors" which might, in other industries, suggest the ability of firms to overcome impediments to coordinated behaviour do not perform that function in commodity markets. In these markets prices are quoted globally and are widely available, (e.g. London Metal Exchange (LME); RISI). It is therefore important that the Draft MEGs stress, more strongly than is now the case, that the factors listed are indeterminate. Factors such as price transparency can encourage competitive

activity because that transparency provides valuable information to buyers. For example, this is very clearly the case in the newsprint industry.

**Section 5.22:**

The point which we have made with respect to paragraph 5.21 applies quite clearly to the heading “Market transparency”. In commodities for which there is a world price, the knowledge about prices charged by rival firms can have no anti-competitive effect. It is vigorous competitive market activity itself which establishes the very prices which then become transparent. And the transparency in pricing thus negotiated brings information to buyers which might not otherwise be available to them.

FPAC recommends a reference to this market reality.

**Section 5.28:**

FPAC believes that this section is particularly desirable in that the requisite analysis is not limited to firms that are within the relevant markets.

**Part 6 – Entry**

**Section 6.2**

FPAC suggests that the reference to poised entry in footnote 76 be elevated and included in Section 6.2. For global industries, the disciplining effect of a poised entrant is similar to a threat of import competition. Thus, full recognition of a poised entrant is appropriate.

**Part 7 – Countervailing Power**

**Section 7.2:**

Buyers can certainly constrain the ability of a seller to exercise market power. However, it may well be the case that the buyers’ ability to switch may not be immediate. The credible threat to switch may, however, effect the appropriate constraint nonetheless.

FPAC therefore suggests that the word “immediately” be omitted from the first “bullet point” in Section 7.2.

**Part 8 – The Efficiency Exception**

**Section 8.10:**

This section deals with section 96(2) of the Act itself. Section 96(2) has always been an interesting provision. It appears to be an addition to section 96(1) so that firms trading

internationally will be able to provide additional evidence of efficiency. But Section 8.10 of the Draft MEGs might suggest otherwise.

Forest products firms are heavily engaged in export trade. Mergers among them characteristically result in significant increases in the real value of exports in that the costs of the Canadian producers are reduced. But there is not necessarily any increase in output by the merged firm. Indeed, there may be a rationalization of output through efficiency gains which eliminate unprofitable product lines.

Further, footnote 96 suggests that increased output “is generally only possible with an associated decrease in price”. As FPAC has emphasized, prices for most forest industry products are established in the world market and a Canadian merger will not, characteristically result in a decrease in price to export customers, even if output is increased.

FPAC would therefore suggest that Section 8.10 of the Draft MEGs be amended by providing that section 96(2) of the Act may be relied upon by merger proponents engaged in export trade to advance further arguments on efficiencies but are not interpreted to define the requirements which export businesses must show in order to demonstrate efficiencies.

### **Part 9 – Failing Firm**

The provisions covering mergers involving a failing firm are well understood. However, there appears to be a gap between mergers involving failing firms and competitive firms. In industries there typically exist firms that are not vigorous competitors but also not failing firms. These struggling firms could be described as “flailing firms”. These firms are higher cost producers but not (yet) at the brink of bankruptcy. The Draft MEGs appear silent on the treatment of mergers involving such “flailing firms”, particularly when pre-merger industry concentrations are relatively high. An argument can be made that supports mergers involving “flailing firms” even in the face of high industry concentrations. Clearly, the firm being acquired does not pose a viable competitive threat in the future and therefore its acquisition would not represent a substantial lessening of competition. FPAC encourages the recognition of the above situation in this part of the Draft MEGs.