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Submission on Merger Enforcement Guidelines Consultation

NATIONAL COMPETITION LAW SECTION
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500-865 Carling Avenue, Ottawa, ON, Canada K1S 5S8
tel/tél : 613.237.2925 | **toll free/sans frais** : 1.800.267.8860 | **fax/téléc :** 613.237.0185 | info@cba.org | **www.cba.org**

PREFACE

The Canadian Bar Association is a national association representing 37,000 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 National Competition Law Section of the Canadian Bar Association, with assistance from the Legislation and Law Reform Directorate at the National Office. The submission has been reviewed by the Legislation and Law Reform Committee and approved as a public statement of the National Competition Law Section of the Canadian Bar Association.

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Submission on Merger Enforcement Guidelines Consultation

I. INTRODUCTION

The National Competition Law Section of the Canadian Bar Association (CBA Section) welcomes the opportunity to respond to the Competition Bureau's open consultation announced on September 7, 2010 with respect to the *Merger Enforcement Guidelines* (MEGs) published in 2004. The CBA Section supports the continuing efforts of the Bureau to articulate its enforcement policies.

II. EXECUTIVE SUMMARY

While not binding as a matter of law, the competition bar and the business community have come to expect that the Bureau will generally follow the MEGs in its analytical approach to merger review and case triage. It is important, therefore, that the MEGs reflect both the body of Canadian merger and related jurisprudence and the approach used by the Bureau in the merger review process, to foster the Bureau's goals of transparency and predictability. Moreover, the MEGs approach is often adopted in other contexts[1] and cases[2]. As such, the MEGs are important in substance. Significant changes to the MEGs are capable of starting a chain reaction of revisions to other guidelines, and reconsideration in merger and related cases. This interrelationship needs to be kept in mind should material amendments proceed.

The CBA Section commends the Bureau, however, for raising the issue of whether the MEGs should be revised at this time. The MEGs were most recently amended and reissued in 2004.

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[1] See, for example, Competition Bureau, *Competitor Collaboration Guidelines* (Ottawa: Industry Canada, 2009); Competition Bureau, *Predatory Pricing Enforcement Guidelines* (Ottawa: Industry Canada, 2008); Competition Bureau, *Enforcement Guidelines on the Abuse of Dominance* (Ottawa: Industry Canada, 2001); Competition Bureau, *Intellectual Property Enforcement Guidelines* (Ottawa: Industry Canada, 2000); and Competition Bureau, *Price Discrimination Enforcement Guidelines* (Ottawa: Industry Canada, 1993).

[2] See, for example, *B-Filer Inc. et al. v. The Bank of Nova Scotia*, 2006 Comp. Trib. 42; i (1997), 73 C.P.R. (3d) 1 (Comp. Trib.); and *R. v. Clarke Transport Canada Inc.* (1995), 64 C.P.R. (3d) 289 (Ont. Gen. Div.).

Subsequently, the Bureau issued a new bulletin on Merger Efficiencies in 2009. There has been no Canadian merger jurisprudence dealing with the analytical approach to merger review and merger efficiencies since 2004. There has been a decision in an abuse of dominance case, but this decision did not affect the substantive approach embodied in the current MEGs[3]. Similarly there has been no amendment to the substantive merger provisions of the *Competition Act*. However, during this same period, the United States, France, the United Kingdom, the European Community[4], and perhaps other countries, have all issued guidelines dealing either with merger review or with competitor collaborations which are analyzed in a fashion similar to merger review. The Bureau itself issued the *Competitor Collaboration Guidelines* in late 2009. Moreover, there are continuous developments in economics that are put into play in the cases reviewed by the Mergers Branch of the Competition Bureau. Unlike the slow and steady pace of changes in the Canadian legal principles applicable to substantive merger review, the changes in the laws of other countries and in the economic approach to merger review are rapid, and arguably less stable. This too must be kept in mind before amending the MEGs in the absence of any corresponding legislative change, and any serious or obvious flaws in the current paradigm.

In summary, the CBA Section believes that the MEGs could usefully be revised at this time, but that substantial amendments are not required.[5] In this submission, the CBA Section identifies provisions that the Bureau should consider amending, expanding on or adding. The CBA Section encourages the Bureau to continue to clarify any changes in its approach to substantive merger review and the application of the principles articulated in the MEGs, and to consult with the competition bar and business community in this regard.

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[3] *Canada (Commissioner of Competition) v. Canada Pipe Co*. (2005), 40 C.P.R. (4th) 453 (Comp. Trib); rev'd (2006), 49 C.P.R. (4th) 241, 2006 FCA 233 ("*Canada Pipe*")

[4] See, for example, United States Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (Washington: U.S. Department of Justice and Federal Trade Commission, 2010) (the "U.S. Guidelines"); Directorate for competition policy, consumer affairs and fraud control, *Lignes directrices relatives au contrôle des concentrations: Procédure et analyse* (Paris: Ministère de l'économie des finances et de l'industrie, 2007); United Kingdom Office of Fair Trading and United Kingdom Competition Commission, *Merger Assessment Guidelines* (London: Office of Fair Trading and Competition Commission, 2010) (the "U.K. Guidelines"); and EC, *Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings* [2004] OJ, C 31/5 (the "E.C. Guidelines").

[5] For greater certainty, the CBA Section does not intend to detract from its earlier submissions recommending changes to certain aspects of drafts of the MEGs and *Efficiencies Bulletin* that were not ultimately accepted in the final versions of those publications.

III. RESPONSE TO BUREAU'S DISCUSSION PAPER

In this part, the CBA Section responds to the questions posed by the Bureau in its discussion paper released on September 30, 2010 as part of the consultation.

Question 1.a

> 1. The MEGs provide that typically, the first stage in the Bureau's review of a merger involves defining the relevant market in which the merging parties operate, followed by a determination of market shares and concentration, and then a competitive effects analysis. Should the Bureau consider:
>
>   a. revising the MEGs to shift emphasis away from the detailed assessment of market definition and more towards a direct assessment of competitive effects?

Section 92(2) of the *Competition Act* instructs the Competition Tribunal not to find that a merger lessens or prevents competition substantially solely on the basis of market share. Further analysis is required before such a conclusion may be reached. The starting point for the Bureau's review, however, should remain focused on market definition. The vast majority of cases can be triaged and dismissed as raising no issues on this basis and so it should be retained as the central initial focus in appropriate cases. In some cases, however, even market definition is not necessary in order to conclude there are no issues (for example, where the parties are not in the same line of business or where the industry is already very competitive).

The further analysis contemplated by the *Competition Act*, however, requires first and foremost a consideration of the factors in section 93 *et seq* of the *Competition Act*. While "competitive effects" is often said to form a focal point in merger review, it is important to clarify that this does not mean the same thing in Canada as it has apparently come to mean in the United States. As the Competition Tribunal noted in *Superior Propane*:

> The Tribunal concludes that evidence of an actual or likely price increase is not necessary to find a substantial lessening of competition. What is necessary is evidence that a merger will create or enhance market power which, according to paragraph 2.1 of the MEG's, cited above at paragraph [57], is "the ability to profitably influence price, quality, variety, service, advertising, innovation or other dimensions of competition". There is no requirement under the Act to find that the merged entity will likely raise the price (or reduce quality or service). The only requirement under section 92 is for the Tribunal to decide whether the merged entity has the ability to do so. [*emphasis added*][6]

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6 *Commissioner of Competition v. Superior Propane Inc.,* (2000), 7 C.P.R. (4th) 385, 2000 Comp. Trib. 15, at para. 258; reversed on other grounds (2001), 11 C.P.R. (4th) 289, 2001 FCA 104.

Moreover, defining the market and determining relevant market shares and concentration remain the process that the Bureau undertakes in the majority of its cases. If this is indeed the case, it would not be appropriate for the MEGs to shift their emphasis away from a detailed assessment of markets and towards a direct assessment of competitive effects.

The MEGs should also reflect the most recent jurisprudence. In Canada, the jurisprudence has yet to favour a move away from a detailed assessment of market definition towards a direct assessment of competitive effects. In the most recent Competition Tribunal decision on point (*Canada Pipe*), the Tribunal refused to adopt the Commissioner's suggested approach of focusing solely on competitive effects.

The revised U.S. Guidelines have generated significant debate about whether the move away from market definition may "substantially erode the predictability of enforcement decision-making and thus, certainty for business planning 'which involves anticipation of the Department's enforcement intent'".[7] It also appears that the U.S. courts have continued to resist the move away from the detailed assessment of market definition. With the U.S. experience in mind, the CBA Section stresses that any revisions to the MEGs should be made with a view to providing clear guidance and certainty to parties evaluating the prospects of a transaction.

Market definition provides the basis for initial market share calculations and concentration levels. That said, as noted above, it is a starting point under Canadian law. As such, particular caution is needed in markets involving differentiated products or markets characterized by a high degree of change and innovation, as market definition is more complex in these cases. For example, different products typically are positioned by their manufacturers along a competitive continuum, and compete with one another to varying degrees. Trying to determine precisely which products are "in" and which are "out" of the market can be arbitrary. Setting a precise boundary for the "market" results in an oversimplification that "cannot capture the full variation in the extent to which different products compete against each other."[8]

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7 D. Garza, *Market Definition, the New Horizontal Merger Guidelines and the Long March Away from Structural Presumptions*, The Antitrust Source, October 2010.

8 U.S. Guidelines, *supra* note 4, at section 4.

Question 1.b

> b. revising or expanding the use of “next best substitutes” and “smallest” market principles (paragraph 3.5 of the MEGs)?

The Tribunal has held that the “smallest” market principle is an important part of the analytical approach to market definition.[9] It is the CBA Section’s view that alternative methods of defining relevant markets may not be as well-suited for assessing market-wide dynamics. Again, in our experience, the Bureau has not moved away from the “smallest” market principle in its assessment of mergers in favour of another approach; if there are any circumstances where this is not likely to be case, then it would be helpful if the MEGs could provide further guidance regarding any such alternative approaches.

With respect to “next best substitutes”, the CBA Section notes that there is an extensive discussion of substitutability at paragraphs 3.11 through 3.18 of the MEGs.

Question 2

> 2. Should the Bureau consider revising the MEGs to provide more detail on the types and sources of evidence the Bureau considers in merger reviews, and the relative weight typically assigned to such evidence? For example:
>
> a. evidence from customers, competitors and other third parties about how they will respond to and be affected by the merger;
>
> b. the degree of competition among the merging parties;
>
> c. documents provided by the parties created prior to and following consideration of the proposed merger;
>
> d. evidence based on "natural experiments", such as comparisons of current prices in geographic markets where both merging parties are present to current prices in geographic markets where only one of the merging parties is present;
>
> e. the role of diversion ratios and price/cost margins in evaluating unilateral effects; and
>
> f. the role of product re-positioning.

The CBA Section generally supports revising the MEGs to provide more detail on the types and sources of evidence the Bureau considers in merger reviews, and the relative weight typically assigned to such evidence. However, the recently issued *Fees and Service Standards Handbook*

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[9] *Supra*, note 6 at 406 (C.P.R.) (Comp. Trib.).

for Mergers and Merger-Related Matters does address some aspects of this, such as market contacts.

Care needs to be taken, for example, as to whether and when the Bureau will contact or consider evidence from competitors about a merger, particularly in a vertical merger. Clearly the *Notifiable Transactions Regulations* contemplate that customers and suppliers will be contacted as part of the merger review process. However, neither the *Competition Act* nor the regulations mandate that evidence of competitors or other market participants is to be considered or given weight. This is particularly problematic where such market contacts allow competitors to "game the system", or where the mere fact of contacting a competitor may tip off the competitor to the strategic aspects of a particular merger under review. The CBA Section would be concerned with a further statement in the MEGs that market contacts were to be routinely or regularly sought out, as Bureau Commerce Officers may be hesitant to deviate from that practice even where appropriate.

That said, the MEGs could be more comprehensive in setting out the sources of evidence that are considered, and the relative probity of documents, business decisions, views of individuals within the merging parties, financial terms of the transaction, views of customers and other industry participants. In particular, having a discussion on how customers' and rival firms' views may be tainted by their particular circumstances and are not necessarily determinative of anti-competitive effects would be helpful. The MEGs contain some references to sources of evidence, but much of the discussion is set out in the context of market definition in Part 3, rather than being generalized to the entire merger assessment. The list in (a) to (f) above reflects areas where the MEGs have little or no content.[10]

Existing Canadian jurisprudence provides little guidance on the question of the types and sources of evidence that *in general* should be relevant to considering adverse competitive effects (and addresses instead specific evidence relevant to the facts of the cases). General guidance would be useful to practitioners and businesspeople so they can focus their competitive effects analyses on the matters of most relevance to the Bureau when it is assessing a particular transaction.

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[10] The utility of the MEGs for both practitioners and the Bureau would be enhanced by gathering the disparate sources of evidence used by the Bureau into an appendix to the MEGs, with an indication of the particular area of relevance in the Bureau's analysis.

As to price-cost margin evidence, there are a number of issues. First, the Bureau needs to be cognizant of the differences between U.S. and Canadian law as well as the criticisms of the U.S. Guidelines. These criticisms are perhaps more acute in Canada, given our more concentrated markets generally (lack of density and broad geography) as well as the burden on both governments and business of managing and assessing such data. For example, the U.S. Guidelines are focused on "margins", i.e., roughly a measure of the difference between the price and cost for a product. This approach postulates that if a company has high margins, customers are unlikely to switch if it raise prices. Therefore, there is a presumption – which may often be false – of market power.[11] The problem with this approach is that it virtually always predicts a price increase or "upward pricing pressure" (the phrase used in the U.S.) simply because the economic calculations and models predict there will be less diversion of customers with one fewer competitor. If this is true, then the merging parties are frequently going to be on the defensive, trying to demonstrate wider markets, and the likelihood of future events like entry and efficiencies, in order to rebut conclusions based on what appear to be "hard" historical pricing data that show upward pricing pressure. In summary, the problem with too much focus on margins is that where margins are high, the approach can often lead to narrow markets, and findings of initial price effects that may not be warranted.

Another concern is that this is a data intensive exercise, and one that removes business certainty and guidance. At a minimum, before this approach is adopted in Canada, it is worth studying whether had such rules been in place in the past, a great many more mergers that were cleared would have been challenged or subject to greater scrutiny.

Question 3

3.	Significant and partial interests and interlocking directorships are addressed in various contexts in the MEGs. Should these discussions be consolidated and/or expanded?

The CBA Section believes that the discussions in the MEGs regarding significant and partial interests and interlocking directorships are helpful and ought to be expanded. Nevertheless, caution is warranted. The CBA Section reiterates concerns expressed in its recent submission on the draft *Fee and Service Standards Handbook for Merger-Related Matters* about the

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11 See, for example, Joseph J. Simons "Comments to the Federal Trade Commission and Department of Justice Antitrust Division, HMG Review Project - Comment, Project No. P092900, Margins in Merger Analysis", April 2010

treatment of interlocking directorships and minority interests.[12] There, we noted that Canada does not have an equivalent to section 8 of the U.S. *Clayton Act* and that, as a much smaller country, interlocking directorships are far more common.

In the CBA Section's view, the discussion of the two topics – partial interests and interlocking directorships – need not be consolidated, and indeed may benefit from separate treatment. For example, it may be beneficial to consider the issue of "significant interest" as it relates to the jurisdictional question of whether a transaction is a merger separate from the substantive question under section 92 of whether partial interests or interlocking directorships are likely to prevent or lessen competition substantially.

Part 1 of the MEGs provides sufficient guidance on what constitutes a significant interest and how the Bureau assesses whether a significant interest has been acquired. Particularly in the context of share acquisitions, the 10% bright-line threshold is helpful and should not be changed.

The CBA Section believes that it would be helpful for the Bureau to expand its discussion regarding when the acquisition of a minority/partial interest may lessen competition. The CBA Section notes the helpful and relevant discussion in the Bureau's submission to the OECD on Minority Interest and Interlocking Directorships. In that submission, the following three factors were flagged as relevant in partial interest acquisitions: (i) the ability to materially influence the economic behaviour of the business; (ii) the ability to seek confidential information; and (iii) a change to incentives (or change in the profit-maximizing function).[13] The recently revised U.S. Guidelines describe the same three factors in the discussion about partial acquisitions. The CBA Section believes that the inclusion of the relevant portions of the OECD submission in the MEGs or in another Bureau policy statement would be useful.

The CBA Section also believes that the MEGs should include guidance on the Bureau's analytical approach to assessing a minority/partial acquisition. The CBA Section understands that, where a merger involves a partial acquisition, the Bureau will initially consider the competitive effects of a hypothetical complete acquisition. If the Bureau's assessment is that a complete

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[12] National Competition Law Section, Canadian Bar Association, *Submissions regarding Draft Fee and Service Standards Handbook for Merger-Related Matters*, August 2010, at 7.

[13] OECD Policy Roundtables, "Minority Shareholdings and Interlocking Directorships", February 2008, at 103.

acquisition is not likely to prevent or lessen competition substantially, there will be no need to assess the extent to which a partial acquisition could be anti-competitive. The CBA Section endorses this approach and encourages the Bureau to indicate if there are particular situations where this approach is not likely to be followed.

A related issue is the Bureau's consideration of pre-existing partial ownership interests. It would be helpful for the Bureau to clarify the extent to which it will normally seek disclosure about an acquiring party's pre-existing minority interests. The CBA Section notes that it is often difficult for clients – particularly private-equity clients – to gather information about each and every business line for all of the entities in which they hold minority interests, particularly small interests. The Section would welcome the adoption of a bright-line threshold on this issue and proposes a threshold of 10% so that it is consistent with the threshold for significant interest. This would be consistent with the analytical approach to significant interests and the fact de *minimis* shareholdings are highly unlikely to create substantive competition law concerns.

Question 4.a

4. Should the Bureau consider expanding the discussion of unilateral effects in the MEGS to include more detail regarding:
   a. bargaining and auction models;

The MEGs currently do not discuss potential unilateral effects arising from a merger in markets where products are sold through bargaining or auction. To the extent that the Bureau's analysis of these markets differs from that where products sales are negotiated, this should form part of any revision to the MEGs. Of particular interest would be how the Bureau uses information regarding:

- the suppliers a buyer considered when making its purchasing decisions through both formal and informal bidding processes;
- the consideration given to whether the merging sellers were the buyers' first, second or some other combination of choices;
- the bidding or auction format;
- capacity constraints; and
- availability of information (particularly sellers' costs and buyers' preferences), and the influence on pricing of this factor.

Question 4.b

> b. when considering differentiated products whether the products of merging parties should be first and second choices of a significant number of buyers;

Regardless of the Bureau's response to question 1, the MEGs should provide more information on the role of first and second buyers (and other tools) when considering unilateral effects in cases of differentiated products.

Determining unilateral effects can be more challenging in cases where products are differentiated. This is acknowledged in the MEGs in the discussion of unilateral effects in cases where firms are distinguished primarily by their products (MEGs, paragraphs 5.14-5.16). The MEGs note that "a merger may create, enhance or maintain the ability of the merged entity to exercise market power unilaterally when a significant number of buyers view the product offerings of the merging parties to be their first and second choices." (MEGs, paragraph 5.14). A merger that would combine competing suppliers of differentiated products may raise the potential for significant unilateral effects if a sufficient proportion of consumers view the products combined by the merger as their first and second choices (or closest substitutes). The Bureau should assess whether the merger would allow the merged firm to profitably increase price on one or more products after the merger, or whether sufficient customers would switch to products of other competitors so as to render such a price increase unprofitable for the merged firm. The Bureau should also consider whether rival sellers likely would replace any loss of competition by repositioning or extending their product lines to compete more closely with the merged firm.

It is not clear how the Bureau proceeds in practice. For example, the Bureau required divestitures in BASF SE's acquisition of Ciba Holding AG where the two companies were identified as "*major* suppliers" of indanthrone blue and bismuth vanadate pigments. However, they were not publicly identified as each other's closest competitors, or, alternatively, closest competitors for a significant number of buyers.[14] In fact, the Bureau rarely, if ever, discusses whether, in cases of markets with differentiated products, a significant number of buyers view the product offerings of the merging parties to be their first and second choices. The CBA

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[14] "BASF Acquisition of Ciba cleared following divestiture commitment", Media Release, Competition Bureau, April 6, 2009.

Section recommends that the Bureau consider expanding this aspect of the discussion of unilateral effects in the MEGs.

As noted in response to question 4a, how product ordering is further considered in markets where product is sold through bargaining or auction would also be welcome. This is particularly the case since in bargaining situations multiple sellers may be played off each other and buyers' first and second choices may not always be known. As such, firms that are not necessarily a buyer's second choice can have an influence on price. In addition, how the Bureau assesses "a significant number of buyers" could benefit from elaboration. It is worth noting that the U.S. Guidelines indicate that "a significant fraction" of buyers viewing the products sold by the other merging firm as their next-best choice need not approach a majority: "A merger may produce significant unilateral effects for a given product even though many more sales are diverted to products sold by non-merging firms than to products previously sold by the merger partner."[15] Finally, where a buyer makes purchases of the same or similar product from multiple suppliers, the relative prices of "third" or lower choice suppliers can influence the allocation of products across all suppliers, including its first and second choices, and as such, lower ranked choices can play a price-disciplining role.

Question 4.c

> c. merger simulations that may include demand estimation, upward pricing pressure or diversion ratio analysis.

Before responding to this question, it is worth noting that demand estimation is not so much a part of merger simulation but a possible prelude to it, resulting in, for example, an estimate of elasticities (demand parameters) that are then used as inputs to the simulation (although there are alternatives to estimating demand parameters such as taking such estimates from previous academic research). The end result of a merger simulation is an estimate of the likely price and surplus effects of a merger, having taken into account the reactions of other non-merging firms. Meanwhile, upward pricing pressure, while possibly using some of the same inputs as a merger simulation, is a quick threshold analysis that considers only the merging firms themselves and does not estimate a price effect. Rather, as noted by Richard Schmalensee:

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15 U.S. Guidelines, *supra* note 4, at section 6.1.

> Merger enforcement has generally been focused on preventing mergers that would produce a significant (and non--transitory) price increase, but UPP (and UPP*) directly measures only the profitability of a tiny increase from pre--merger prices. It does not indicate whether the merger would produce more than a tiny price increase. Imagine starting to walk up a hill in fog so dense that you can only see a few feet ahead. The steepness of the path at the bottom of the hill is like UPP. Just as the steepness of the path at the bottom doesn't tell you how high the hill is, so the magnitude of the UPP doesn't tell you how large the post-merger price increase would be.[16]

Diversion ratio analysis, meanwhile, is typically used as an input to an upward pricing pressure calculation. It can also be used as input to merger simulations.

The Bureau should consider expanding the discussion of unilateral effects in the MEGs to include more detail regarding merger simulation (including demand estimation), upward pricing pressure or diversion ratio analysis to describe this use by the Bureau, the circumstances in which they are likely to be used, and the extent to which such modelling exercises are likely to be relied upon. It would also be of use if the Bureau were to state its views on the pros and cons of various techniques which the Bureau regularly uses, in which types of cases and to which the Bureau is likely to be favourably disposed. For example, the 1991 version of the MEGs referred to the use of price correlations[17] while the current version does not, suggesting that this technique has fallen out of favour with the Bureau. Any explicit statement by the Bureau on its views on this and any other quantitative techniques would be welcome.

The CBA Section recommends, however, that the Bureau – in any revised MEGs or elsewhere – not go so far as to use or suggest the use of the results of such techniques as safe harbours or near safe harbours. In particular, we recommend that the Bureau steer clear of the following type of statement as contained in the U.S. Guidelines: "The Agencies rely much more on the value of diverted sales than on the level of the Herfindahl-Hirschman Index (HHI) for diagnosing unilateral price effects in markets with differentiated products. If the value of diverted sales is proportionately small, significant unilateral price effects are unlikely."[18]

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[16] Richard Schmalensee, "Should Merger Guidelines Give UPP Market Definition?", *GCP: The Antitrust Chronicle*, Competition Policy International, December 2009, at 4. Schmalensee uses the notation UPP to refer to upward pricing pressure and UPP* to refer to upward pricing pressure that includes any post-merger cost changes.

[17] MEGs, at para 3.2.2.6.

[18] U.S. Guidelines, supra note 4, at section 6.1.

While the value of diverted sales can be informative, such analysis does not lend itself for use as a safe harbour for several reasons. First, while it is known that the value of diverted sales will always be positive for the merger to be of any interest at all to the Bureau, it is not clear even in the U.S. Guidelines how small this positive number must be to be considered "proportionately small". This is particularly of concern since the U.S. Guidelines also indicate that "[a] merger may produce significant unilateral effects for a given product even though many more sales are diverted to products sold by non-merging firms than to products previously sold by the merger partner."[19] This suggests that quite a small number may still not be sufficiently "proportionately small".

Second, quantitative techniques of any sort are only possible if the necessary data are available and, if available, are only as reliable as that data. Even in cases where the quality is high for a considerable period, little can be meaningfully concluded if there is variability within the data. The U.S. Guidelines suggest that information such as "documentary and testimonial evidence, win/loss reports and evidence from discount approval processes, customer switching patterns, and customer surveys"[20] are relied upon to evaluate the likely size of diverted sales for use in determination of an upward pricing pressure or other quantitative techniques. However, the CBA Section believes that such information is largely qualitative in nature and often not suitable for the purpose of quantitative techniques.

Third, merger simulations that use reliable inputs and that are modeled to accurately reflect market characteristics tend to be resource - and time - intensive. Safe harbours should, however, be based on readily available and easily understood information. The upward pricing pressure test attempts to do this but it is of note that it relies on an estimate of the diversion ratio, which is ideally estimated on the basis of the firm's own- and cross-price elasticities of demand, which are typically not readily available. As a result, the diversion ratio is often "guesstimated" on the basis of the type of information referred to above. Further, a measure of incremental cost, which is also typically not available, is instead based on controversial proxies such as average variable cost and average cost. Moreover, since the (gross) upward pricing pressure always results in a positive number, as long as the two firms' products are at least to

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[19] *Ibid.*

[20] *Ibid.*

some degree substitutes, it does not provide an easily understood figure, and tends to lead to a negative bias against the merger.

Regardless of which merger simulation tools the Bureau chooses to employ, the CBA Section urges the Bureau not to undertake in routine merger cases the various complex, costly and time-consuming economic analyses which may suffer from the shortcomings alluded to above.

Question 5

5. Is the discussion of coordinated effects in the MEGs sufficient, or should the Bureau consider providing in the MEGs some further discussion of how the Bureau assesses potential harm from coordinated exercises of market power?

The CBA Section believes that it would be beneficial for the Bureau to include further discussion in the MEGs on how it assesses potential harm from coordinated exercises of market power. The MEGs currently contain an extensive discussion of coordinated effects, which is a welcome improvement over the original 1991 guidelines. However, the focus of the discussion is on the conditions likely to give rise to coordinated behaviour and allow it to be sustained. The familiar criteria of individually recognizing mutually beneficial terms of coordination, having an ability to monitor conduct and detect deviations, and having the means to respond to deviations through effective deterrent mechanisms are expanded upon and clearly articulated. In this respect, the treatment of coordinated effects in the MEGs is similar to the discussions found in the U.S. Guidelines and the E.C. Guidelines.

Unfortunately, by focusing mainly on facilitating practices, there is sparse discussion of the nature and extent of the harm necessary to conclude that a transaction will substantially lessen or prevent competition. The MEGs currently state that "coordinated behaviour can involve tacit or express understandings on price, service levels, allocation of customers or territories, or any other dimension of competition."[21] In the interests of transparency and predictability, it would be beneficial to expand this discussion to provide greater clarity on how the Bureau assesses potential harm in coordinated effects cases.

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[21] MEGs, at para 5.19.

Question 6

6. Should the Bureau consider incorporating in the MEGs a discussion of the potential effects that a merger of competing buyers may have on upstream markets?

Yes. A discussion of the Bureau's view on agreements between competing buyers is already contained in the *Competitor Collaboration Guidelines* in the context of joint purchasing agreements and buying groups. Since a merger between buyers is merely another way formerly competing buyers may affect competition at the supplier level, it would be peculiar if the position and approach in the *Competitor Collaboration Guidelines* did not have application in the context of merger review. The CBA Section urges the Bureau to make this clear in any revised MEGs.

Such a clarification would also improve paragraph 2.4 of the MEGs, which currently provides insufficient guidance as to what is meant by prices depressed below "competitive levels" and how the analytical framework applicable at the downstream level is to be applied upstream. Such guidance would be particularly welcome since mergers with possible upstream effects are not uncommon.

Question 7

7. Is the discussion regarding prevention of competition (paras 2.10 – 2.12) in the MEGs sufficient, or should the Bureau consider providing further guidance on how the Bureau assesses the theories of "potential competition" and "actual competition"?

The CBA Section believes that this discussion is sufficient, and does not need to be amplified. See the discussion of potential competition in connection with entry in Question 12b, below.

Question 8

8. The MEGs provide that, when price discrimination is feasible, it may be appropriate to define relevant markets with reference to the characteristics of the classes of buyers or to the particular locations of the targeted buyers. Should the Bureau consider including an expanded discussion of price discrimination in both market definition and the assessment of competitive effects? Should the Bureau consider incorporating a discussion of the conditions when the Bureau, for practical reasons, may define relevant geographic markets based on location of suppliers, rather than the location of customers?

Paragraphs 3.9 and 3.19 of the MEGs outline an approach to market definition based on price discrimination, which is informative. That said, the CBA Section would welcome further guidance regarding the circumstances in which the Bureau believes it is appropriate to use the characteristics of the classes of buyers as relevant to its determination of the relevant markets in any revised draft of the MEGs. Similarly, the CBA Section would welcome further guidance regarding the Bureau's approach to defining relevant geographic markets based solely on the location of targeted suppliers.

Customer preferences sometimes are accorded more weight in the Bureau's assessment of a transaction than they deserve in competition law terms. The MEGs could point out, for the benefit of non-specialists, that mere customer preferences to use a particular product do not necessarily establish a separate product market.

Question 9

9.	When determining, for the purposes of market definition, whether a hypothetical monopolist would find it profitable to impose at least a small but significant and non-transitory increase in price, in most cases, the Bureau considers a five percent increase to be significant. Should the Bureau consider providing further explanation as to when the Bureau may consider an increase of less than five per cent to be significant?

The CBA Section believes that the SSNIP test is helpful and should remain in the MEGs as the general approach to market definition using the hypothetical monopolist test. However, examples of when the Bureau deviates from 5% or one year would be useful (expanding on footnote 27), as would a clearer distinction for the benefit of non-specialists that these figures relate to market definition rather than the determination of whether there is a material price increase (set out in paragraph 2.13 of the MEGs).

Generally, the CBA Section is of the view that a 5% threshold as the appropriate threshold may be too low and the Bureau should consider changing the appropriate threshold to a range of 5 to 10%.[22] If the Bureau has considered an increase of less than 5% to be significant in certain circumstances, then further explanation and guidance on these circumstances would be

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[22] There is support in E.C. and ICN publications for use of such a range. See *Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services* [2002] OJ, C 165/6 at 40; and International Competition Network, ICN Recommended Best Practices for Merger Analysis, Section II B, comment 3 (page 6): http://www.internationalcompetitionnetwork.org/uploads/library/doc316.pdf.

helpful. Further guidance would also be welcome on whether the amount of the price increase may be higher or lower depending on factors such as industry, price, customer, etc.

It would also be useful for the MEGs to provide further guidance regarding the circumstances in which the Bureau will use a price other than the prevailing competitive price as the base from which to postulate a price increase.

Question 10

> 10. The market concentration thresholds in the Horizontal Merger Guidelines recently issued by the competition authorities in the United States (U.S. Guidelines) were updated. These Guidelines now note that changes in the number of competitors may actually be more significant in some contexts. While the U.S. Guidelines differ from the MEGs in their measure for market concentration (Herfindahl-Hirschman Index versus post-merger market shares), are the current thresholds in the MEGs sufficient or should the Bureau consider a similar change?

The MEGs currently provide that the Commissioner generally will not challenge a merger when the post-merger market share accounted for by the CR4 would be less than 65%, or the post-merger share of the merged entity would be less than 10%. The 65% CR4 threshold is exceeded in many Canadian industries, pre-merger. Although the MEGs are clear that mergers exceeding the threshold are not necessarily anti-competitive, if the threshold does not reflect enforcement practice, it should either be adjusted or replaced with an alternative standard.

Common critiques of the CR4 include: (1) it arbitrarily focuses on the four largest firms in the market, and (2) it does not capture the change in concentration resulting from the merger. On the other hand, the HHI gives weight to all firms in a market and captures the change in concentration. Paragraphs 4.15 through 4.17 of the MEGs currently provide for alternative methods of measuring concentration, including distribution of market shares and the changes in shares over time, as well as the number of firms in the market, change and innovation and the HHI. The CBA Section believes these methods could be given greater prominence, and, in respect of the HHI analysis, supports consideration of incorporating a “delta” threshold (i.e. the change in HHI as a result of the merger), under which the Bureau would not challenge the proposed merger.

Question 11

11.	Should the Bureau consider incorporating a more expansive discussion of the characteristics that constitute a "maverick" firm?

The MEGS would benefit from an expansion and clarification of the Bureau's treatment of "maverick" firms. The principal issue is the extent to which there is a meaningful difference between a "maverick" and a "vigorous and effective competitor".

The Bureau's Technical Backgrounder on the Microcell case, published in April 2005, contains a useful definition of a maverick:

> A maverick is a firm with a strong incentive to deviate from coordinated behaviour and to thereby provide a strong stimulus to competition in the market. For example, such a firm may have less to gain from coordination or be less threatened by punishments from rivals because of the kinds of products it sells or its cost structure. In a market that is otherwise predisposed toward coordinated behaviour, the removal of a maverick could lead to a significant lessening of competition.

In the section on coordinated effects, the MEGs refer to activities of a "particularly" vigorous and effective competitor, which is identified as a "maverick"[23]. It defines a "maverick" as a "firm that has a disproportionate incentive to deviate from coordinated behaviour" citing, as an example, that a firm may have a lower cost structure than its rivals.[24] However, given that the discussion occurs in the context of coordinated effects, its broader relevance is unclear.

The MEGs refer in several instances to the role of one or more "vigorous and effective" competitors in the context of anti-competitive effects generally.[25] Whether a merger will likely result in the removal of a vigorous and effective competitor is an enumerated factor set out in subsection 93(f) of the *Competition Act*. The MEGs identify various possible traits of a vigorous and effective competitor[26] but conclude that the removal of such competitor "is generally not sufficient to warrant enforcement action…".[27]

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[23] MEGs, at paras 5.31 and 5.32.

[24] MEGs, at para 5.31 n. 75.

[25] For example, see paras 5.3, 5.5, 5.6, 5.14.

[26] At para 5.5.

[27] At para 5.6.

To better differentiate maverick firms from the vigorous and effective competitors, and clarify whether they have special significance, it would be helpful to introduce the concept of a "maverick" into the more general discussion of vigorous and effective competitors in Part 5 of the MEGs. The MEGs should discuss situations where the elimination of a maverick firm is likely to lead to a substantial lessening or prevention of competition and provide examples. As part of the discussion, the Bureau could address whether it would rely only on a perceived "disproportionate incentive to deviate from coordinated behaviour" or whether it would be more accurate to say that a true maverick would have actually exhibited a pattern of particularly vigorous competition and resistance to cooperation or following prices of competitors. Further, the MEGs could identify reasons other than cost structure to explain why a putative maverick firm may discipline a market, including whether the firm can expand quickly using available capacity.

Question 12.a

12. Entry and Expansion
    a. The current MEGs assess entry based on the likelihood that it will occur within a two-year period (paragraphs 2.14 and 6.3). Should the Bureau revisit this two-year period? (The U.S. Guidelines have eliminated this requirement and provide a simplified discussion of ease of entry and its role in merger analysis.)

The U.S. Guidelines have abandoned the 1992 U.S. Guidelines'[28] requirement that entry take place within two years to be considered timely, requiring instead that entry take place "rapidly and easily" enough such that the "the prospect of entry . . . will deter or counteract any competitive effects of concern."[29] While a two-year threshold for entry is no longer applicable in the U.S., it is still employed in other major jurisdictions, including the U.K.[30] and the E.C.[31] The current MEGs provide that timely entry "normally must occur" within two years.[32] The CBA Section believes that this qualified presumption remains justified.

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28 U.S. Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines* (Washington: U.S. Department of Justice and the Federal Trade Commission, 1992).

29 U.S. Guidelines, *supra* note 4, at section 9.

30 U.K. Guidelines, *supra* note 4, at para 5.8.11.

31 E.C. Guidelines, *supra* note 4, at para 74.

32 MEGs, at para 6.3.

The CBA Section believes that the existing two-year period is a useful benchmark where the object of assessment is not the date of actual entry but the date on which competition cannot be said to be substantially less than it would have been absent the merger. However, it is important to keep in mind that actual entry is not necessary to prevent merging parties from accumulating market power – it is sufficient that the merging parties believe that timely and sufficient entry would likely occur within a relatively short period of time, and therefore that an attempt to increase prices following completion of the transaction would negatively impact the discounted net present value of the firm's profit stream. As a result, it should not be necessary to prove that a particular entity has plans to actively enter the business in the event of higher prices.

The relationship between the perceived threat of entry and market power ties into a consideration of the appropriate time period, as it helps clarify the object of entry analysis, namely to determine whether any recurring anticompetitive effects have an expiration date, after which time the merger will not substantially prevent or lessen competition.

With respect to departure from the two-year "default" period, there are a number of circumstances the Bureau could address. These include circumstances in which all customers are locked into long-term contracts. The Bureau should also consider acknowledging that timely entry in the case of durable goods may require more than two years, but may still be a relevant consideration in assessing likely competitive effects.[33]

The MEGs are currently silent on the issue of competitive harm occurring in the period pending entry.

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33 Am. Bar Assn, Section of Antitrust Law and Section of International Law and Practice, "Joint Comments on Merger Enforcement Guidelines (Draft for Consultation March 2004) of the Competition Bureau of Canada" , May 25, 2004, at 8, *available at* http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/ct02859_1.pdf/$file/ct02859_1.pdf; see also, U.S. Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines* (Washington: U.S. Department of Justice and the Federal Trade Commission, 1997) (providing "[w]here the relevant product is a durable good, consumers, in response to a significant commitment to entry, may defer purchases by making additional investments to extend the useful life of previously purchased goods and in this way deter or counteract for a time the competitive effects of concern. In these circumstances, if entry only can occur outside of the two year period, the Agency will consider entry to be timely so long as it would deter or counteract the competitive effects of concern within the two year period and subsequently.").

Question 12.b

b. Should the Bureau consider addressing different kinds of entry and how the Bureau addresses evidence relating to entry? (The U.S. Guidelines now emphasize the importance of actual entry into the relevant market.)

The CBA Section recommends that the MEGs be revised to acknowledge the beneficial effects of (1) poised/perceived entry, and (2) expansion by existing competitors.

Potential competitors can discipline the behaviour of existing competitors without ever formally "entering" the market.[34] Emphasizing actual entry alone ignores the important competitive dynamics that can be (and often are) reflected in business documents or historical pricing data. As an economic matter, the CBA Section does not believe that actual entry is necessary to discipline prices post-merger. Moreover, it would only be in limited circumstances that merger parties would be able to demonstrate entry is likely as a result of the merger.[35]

The CBA Section believes that the MEGs would also benefit from a more robust discussion of factors relevant to whether entry or expansion likely would be sufficient to discipline the merging parties (particularly with respect to barriers to expansion, as expansion is more likely than fresh entry in most circumstances). Relevant factors that could be addressed in the MEGs include available production capacity, economies of scale from expansion, access to distribution infrastructure and other inputs, and consumer preferences.

Finally, with respect to assessing the sufficiency of entry or expansion, the CBA Section recommends that the MEGs be revised to acknowledge that sufficient entry can occur through a variety of industry structures, as opposed to entry by a single competitor at a "minimal viable

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[34] This was acknowledged in a footnote to the draft version of the Bureau's Merger Enforcement Guidelines, but removed without explanation from the final version; see Competition Bureau, "Draft Merger Enforcement Guidelines", at para 6.4 n.76 ("Poised entry can in some circumstances provide a disciplining effect on an incumbent contemplating an exercise of market power."), *available at* http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01693.html. The disciplining force of poised entry is also acknowledged in merger guidelines from other jurisdictions, such as the U.K. See U.K. Guidelines, supra note 4, at section 5.8.15 ("A constraint from potential entry may arise even though there may be no expectation on the part of the Authorities that entry would actually occur.").

[35] While parties may be able to prove that entry is occurring in any event, this is not really "entry" in a structural merger analysis but rather future competition. "Entry" involves new firms entering the market as a result of the opportunities created by the merging parties reducing output or increasing prices.

scale."[36] For example, as the U.S. Guidelines and the recently revised U.K. Guidelines both recognize, smaller scale entry or expansion of multiple firms collectively replacing any output likely to be lost as a result of a merger can be a sufficient disciplining force. [37]

Question 12.c

> c. Does the discussion in the MEGs relating to firms' participation in relevant markets through a supply response (paragraph 4.2) more appropriately belong in an evaluation of barriers to entry and expansion? How useful is this distinction?

The distinction has little practical implication and probably should be addressed in the discussion of entry and expansion. This is addressed in the U.S. Guidelines, which distinguish between rapid entrants and new entrants:

> Firms that are not current producers in a relevant market, but that would very likely provide rapid supply responses with direct competitive impact in the event of a SSNIP, without incurring significant sunk costs, are also considered market participants. These firms are termed "rapid entrants" . . . . Entry that would take place more slowly in response to adverse competitive effects, or that requires firms to incur significant sunk costs, is considered in Section 9 [under entry].[38]

Additionally, the E.C. Guidelines already recognize that "[w]hen analysing the possible expansion of capacity by rivals, the Commission considers factors similar to those described . . . on entry." [39] Indeed, collapsing the discussion of supplier response with new entry would ensure that a consistent approach is taken to default time frames (supplier response in paragraph 4.1 of the MEGs requires entry within one year versus two for entry). [40]

That said, the MEGs would benefit from the clarification that, when calculating market shares, capacity being used to produce a different good should not necessarily be excluded where it is easy to shift production.[41]

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[36] MEGs, at para 6.7.

[37] U.S. Guidelines, *supra* note 4, at section 9.3 ("Entry by one or more firms operating at a smaller scale may be sufficient if such firms are not at a significant competitive disadvantage"); U.K. Guidelines, *supra* note 4, at section 5.8.10 ("Small-scale entry, when the market share of the entrant is small compared with that of the merged firm, may nonetheless be sufficient to prevent an SLC for undifferentiated goods where there are no barriers to further expansion.").

[38] U.S. Guidelines, *supra* note 4, at section 5.1.

[39] E.C. Guidelines, *supra* note 4 at section 34, n.45.

[40] MEGs, at para 4.1.

[41] See, for example, U.S. Guidelines, *supra* note 4, at section 5.1 ("[A] supplier with efficient idle capacity, or readily available 'swing' capacity currently used in adjacent markets that can easily and profitably be

Question 13

13. Should the Bureau consider including in the MEGs illustrative examples of the application of the Bureau's analytical approach to merger review and, if so, which sections of the MEGs would benefit from the inclusion of examples?

The U.S. Guidelines contain 24 examples to illustrate certain points. These breathe life into what are otherwise abstract concepts. For example, examples 16 and 17 in the U.S. Guidelines concerning rapid entrants help considerably with an understanding of how certain entrants would be assessed. Though the CBA Section disagrees with the new time period in the U.S. Guidelines for assessing likelihood of entry, examples of this type would be useful in Part 6 of the MEGs and elsewhere.

Question 14

14. The Countervailing Power section of the MEGs (paragraphs 7.1 – 7.3) contains a discussion of when buyers may be able to credibly constrain the ability of a seller to exercise market power. Should the Bureau consider revising the MEGs to discuss buyers that may have a credible alternative to self-supply or sponsor entry, and what further evidence would be required to establish that such buyers are immune from or mitigate harm owing to the loss of competition arising from the merger? Where some buyers may be protected owing to countervailing power, should the Bureau consider expanding the discussion in the MEGs regarding the protection of smaller buyers from an exercise of market power?

The MEGs currently provide a useful discussion of the principles involved is assessing countervailing market power. In paragraph 7.2, the MEGs set out the ways in which buyers can credibly constrain market power by the ability to switch suppliers, to self-supply or by sponsoring new entry or the expansion of existing small suppliers. In these respects, the MEGs already recognize "buyers that may have a credible alternative to self-supply or sponsor entry". In the E.C. Guidelines at paragraph 65, it is noted that buyers may also exercise countervailing buyer power by refusing to buy other products produced by the supplier or, in the case of durable goods, delaying purchases. In addition, large buyers may be able to constrain market power in one geographic market because of their purchases from the merged firm of the same or different products in other geographic markets where the competitive conditions are

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shifted to serve the relevant market, may be a rapid entrant"); U.K. Guidelines, *supra* note 4, at section 5.3.6 (acknowledging that measures of capacity should take into account capacity that could be quickly shifted (from another product) to supply the product in question in response to a price increase and new capacity that could be quickly brought online).

different than in the markets affected by the merger. Paragraph 7.2 could be expanded to include these other examples of how countervailing market power can be exercised.

Since the determination of price discrimination markets and the possibility of the exercise of countervailing power by buyers are inextricably linked, it would be useful to acknowledge this in Part 7 of any revised MEGs.

Any additional guidance that the Bureau is able to provide on the evidence it would consider relevant to the question of countervailing power would be welcomed.

IV. ADDITIONAL COMMENTS

The CBA Section raises the following comments about subjects not addressed in the Bureau's discussion paper.

Failing Firm

The CBA Section believes that the Bureau could assist merging parties and other stakeholders by providing greater guidance about when and how the Bureau will be satisfied that, in the case of a failing firm, there are no competitively preferable alternatives to the proposed merger.

The timing of the Bureau's review of a proposed merger involving the acquisition of a failing firm is important: the parties naturally wish to complete their transaction before the target fails. If a proposed merger is "non-complex" according to the Bureau's service standards, it is unlikely that the Bureau would need to resort to a failing firm analysis to conclude in a timely way whether a substantial lessening or prevention of competition is likely to result. Accordingly, the failing firm analysis is likely to be most critical for "complex" mergers where there may be real issues as to whether the firm will survive for the period of the Bureau's review.

It is important in these circumstances that the parties and others are aware of the ground-rules the Bureau will apply. The Bureau should better explain what must be done to be satisfied that a sufficient search has been conducted to elicit offers for the failing firm from a preferable alternative purchaser, and under what circumstances the Bureau would accept the failing firm argument in spite of the possibility that a third party may later make a binding offer. The

Bureau should address the types of conditions that the failing firm would be required to accept as part of its requirement to elicit offers from competitively preferable purchasers.

Efficiencies

In its September 2008 submission with respect to the Bureau's Draft Bulletin on Efficiencies in Merger Review, the CBA Section urged the Bureau not to issue a separate efficiencies Bulletin but to update and consolidate its comments with respect to merger process in its primary publication on the merger process, the MEGs. The Bureau proceeded to issue the final version of the Bulletin on Efficiencies in Merger Review in March 2009. The Bulletin develops the approach outlined in Part 8 of the MEGs with certain helpful additional guidance, but is also duplicative and, in some instances, inconsistent with the MEGs.

The CBA Section continues to be of the view that Part 8 of the MEGs should be updated to ensure consistency of the message about the Bureau's thinking on this important but sometimes challenging subject. For the sake of consistency and to avoid confusion, it would be particularly important to update Part 8 in the event that the Bureau decided to revise other portions of the MEGs. The CBA Section refers the Bureau to the specific comments on efficiencies advanced in its September 2008 submission.

V. CONCLUSION

The CBA Section thanks the Bureau for the opportunity to submit these comments and hopes they will be of assistance. The CBA Section would be pleased to discuss its comments further at the Bureau's convenience.