THE UNIVERSITY OF MANITOBA

THE ECONOMICS OF HORIZONTAL MERGERS WITH PARTICULAR REFERENCE TO COMPETITION AND MONOPOLY POLICIES IN CANADA AND GREAT BRITAIN TO 1970

by

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THESIS ABSTRACT

The thesis is based on the economics of horizontal mergers and examines on a comparative basis the public policies of Canada and Great Britain with respect to mergers of this type. The principal objective is to evaluate the use of legislation by Canada and Great Britain to protect the public interest in horizontal mergers.

The study is divided into five chapters. The first chapter is mainly concerned with the definition and forms of mergers and the methods by which they may proceed. The second chapter examines the reasons and motivational factors which play an important part in the decisions of firms to grow by means of merger. The third and fourth chapters review the Canadian and British legislation which is relevant to horizontal mergers and provide the examination of the application of public policy in the two countries. The fifth chapter presents an evaluation and conclusion.

Examination of mergers reveals that they can proceed by a variety of methods and for a number of different reasons. Also, industry appears to be subject to surges in merger activity. Investigation of the economics of horizontal mergers and their possible effects shows that the implications for the public interest are ambiguous. On the one hand mergers can directly contribute to the efficiency of industrial operations through specialization and a larger scale of operation. Furthermore, they may provide more balance

in competitive strength in an industry. However, mergers can be the most expeditious way to consolidation and monopolization of industry. Thus the ambiguity in the results of mergers poses a basic dilemma for public policy: how to prohibit those mergers which are against the public interest, however conceived, and allow those that are beneficial.

The application of merger legislation is, in Canada and Great Britain, a relatively recent development. In Canada serious investigation and prosecution of mergers waited until the 1950's, while in Great Britain specific merger legislation was passed only in 1965.

In spite of a substantial commonality in the use of law important differences, explained on historical and constitutional grounds, are evident in the development of merger legislation in Canada and Great Britain. In Canada, merger provisions in the anti-combines legislation operate on a criminal law basis, while in Great Britain the legilsation developed in a later period through civil law and administrative procedures.

Experience with merger legislation in Canada is slight as it is based on only a few cases and has been largely abortive. The criminal law basis of the legislation sets very high standards of proof and, additionally, the application of the legislation in the Courts has been rigid and has given merger activity very wide latitude. There appears to have been a wide divergence in criteria and standards in use by investigators of the Restrictive Trade Practices Commission on the one hand and the judges on the other. In Great Britain investigating activity has been more widespread, though recent. The pragmatism of the approach has provided greater flexibility but again appears to frustrate the development of serious public policy because almost anything can be rationalized in examination. In Great Britain, also, the short time given to the Monopolies Commission to complete a merger reference appears to provide an insufficient research basis. Finally, the wide range of relevant considerations to be entertained in a particular merger have made an evaluation of its net benefits extremely difficult.

On the basis of Canadian and British experience the thesis argues that the use of merger legislation in both combines has been substantially ineffective in protecting the public interest in terms of the preservation of competitive conditions. In Canada, the use by the Courts of a standard of virtually complete monopoly means the damage to the public interest must be extreme and probably largely irreparable before a conviction is likely to be obtained. In Great Britain, it is argued that the approach has been so diffuse and variable that the purpose and justification of the use of legislation is open to question.

The conclusion of the thesis is that effective control of mergers requires the adoption of better control techniques based on a wider and clearer concept of economic policy. Evaluation of mergers must be in the light of the economic facts of the national situation rather than subject to the restrictions of inappropriate law or capricious administration. More comprehensive public policy for economic development, possibly incorporating overall economic planning, is needed to provide coherence, explicitness and continuity in the evaluation of criteria for the evaluation of mergers.

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CHAPTER I

INTRODUCTION

Mergers and acquisitions are among the principal forms of company growth.[1a] Horizontal mergers have been a prominent feature of the post-World War II industrial scene in a number of industrial countries. For the individual firm, merger is one of the means of achieving an instant increase in size desired to improve the market and industrial position of the firm. Mergers may be defensive against existing competition, or they may be offensive and designed to restrict competition and gain monopoly power. Theoretically, mergers have had the main effect of promoting efficiency in some industries,[1b] while increasing market concentration in others. Hence, mergers have aroused serious controversies and considerable thought has been given in recent years to this important problem of industry.

This thesis is a study of the economics of horizontal mergers and the public policy of Canada and Great Britain towards these mergers. The thesis examines how the two countries have used legislative measures to promote the public interest.

For both firms and industries there are explanations of merger activity. The explanations range from the simple to the complex - from simple investment decisions for profit to elaborate strategies to achieve economic power, from mergers which provide a better balance or side of resources to long-term plans to dominate an industry. But before we actually take up the problem of explaining

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[1a] For instance in 1968, 1,433 mergers took place in British industry (see Table 2).

[1b] This should be applicable in an industry with excess capacity.

the causes and effects of mergers in general, let us understand what is meant by "mergers" in general and "horizontal" mergers in particular. Thereafter we shall proceed to discuss the methods and forms of mergers.

Definition of a Merger

Industrial combination by whatever name called, refers to any informal or formal combining of two or more industrial units, proprietary or corporate entity, producing similar or different articles or engaged in the successive process of manufacture of an article, with a view to earning maximum profit on the capital employed. Thus the term "merger" refers to the combination of two or more business entities into a unified whole. In the next chapter we shall be discovering the complex nature of the motivating factors behind the formation of mergers. However, it is important to note that the forms and modes of operation of mergers are determined by the special needs of the promoters in each industry and the socio-economic conditions of the countries concerned.[2]

In every merger transaction four elements are usually involved, according to the following illustrations.[3]

A - A group of assets organized as an income producing unit.

AA - The group owing A - usually the shareholders represented by a board of directors but sometimes an individual proprietor or proprietors.

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[2] In this paper, firms, enterprises, companies, corporations are interchangeably employed to refer to organizations of persons and material resources organized for the purpose of conducting a business of some kind in industry.

[3] This illustration is quoted from John A. Bushnell, Australian Company Mergers: 1946-59 (London: Cambridge University Press, 1961), p. 6.

B - Another group of assets organized as an income producing unit.

BB - The new group owing B.

Before the merger the position was that AA and BB are not similar, that is the same people do not dominate or control the group owing A and B. A small number of large shareholders (e.g., financial intermediaries) may be the same, but no small group has the control of both group of assets. It is only when the merger does take place that the new group CC acquires the right of control.

Bushnell has pointed out that mergers can occur without a change in effective control of the business operations. To illustrate his point, we shall cite the following example: If company AA held 30 per cent of the shares in another company B, it could undoubtedly exercise control if the other shares were widely distributed. If AA purchased an additional 21 per cent or more of the shares, such a transaction would be counted as a merger, although no real change in control occurred.

Types of Mergers

(a) Horizontal Mergers - consists of amalgamations between firms which are engaged at the same stage of manufacture of some products. For example, the combination of two automobile manufacturing firms. Horizontal mergers involve firms in the same industry, and operate across product lines rather than moving up and down a given product line. Although a horizontal merger may involve the same products, yet it can also involve products which are substitutes, such as metal cans and plastic jars. Horizontal mergers may give certain advantages to the parties concerned. For example, they can increase their financial power and thus have easy access to capital markets.

(b) A Vertical Merger - may be defined as the unified control of more than one successive stages in the production of goods and services. It involves combinations between firms in which supplier or buyer relations are present. Vertical integration may be described as the functional co-ordination of one or more units in each of the several successive stages of production so that they are all operated as a single unified industrial process. Vertical mergers may continue operating in the same product lines but take over more of the processes.

Vertical mergers can take the form of forward integration by manufacturers of final products, when they control the channels of distribution into consumer markets. Alternatively, they can represent backward integration. An example would be a steel manufacturer who controls or owns an iron ore mine. In technologically, advanced industrial societies, vertical integration in industry has assumed wide proportions. This may be found in an automobile manufacturing firm, like the General Motors, where it is difficult to find a generally accepted starting point of the complicated manufacturing processes involved. Some firms merely assemble parts while others reach backward toward raw materials in varying degrees. Professor Burns points out that for the purposes of the antitrust laws, "vertical integration exists if goods can be sold at various stages of manufacture or distribution under the control of a single enterprise."

By regularlizing the supply of raw materials or component parts and moving toward the markets of final products, vertical mergers help improve stability by reducing fluctuations in business. The combination of the various stages of production and distribution may produce economies and thus help to improve profit margins of firms.

(c) Conglomerate Merger - A conglomerate is any merger which cannot be classified as being primarily horizontal or vertical. Because of the wide range of merger activity involved, a conglomerate can be defined as the unification of firms whose products may be only remotely if at all related. Compared with horizontal and vertical mergers pure conglomerates would appear to have the least theoretical potentiality for scale economies. The relative newness of this term in its business context is matched by the equally undefinable character, structure, objectives and consequences of conglomeration.

There are three kinds of conglomerate mergers: (1) market extension mergers which involve firms whose market areas do not overlap completely; (2) product extension mergers which involve product additions with sufficient differences to involve new managerial problems; and (3) conglomerate mergers which are not classed as market or product extension mergers are categorized into a general or "other" category. This classification is based on the requirements of the antitrust laws of the United States. While concentric mergers involve corporations which have some product, process or market relationship, pure conglomerates are those whose products, processes and markets may be almost completely unrelated.

Describing the outburst of the conglomerate era, Professor Vance observed that,

> "... market saturation in some industries and the boom or-bust-character of other industries together with the threat of antitrust action has now pushed many growth-minded entrepreneurs out of the manufacturing and marketing expansion reuter and forced them to move into a new super form of 'management' merger - conglomeration." 5

The following are the characteristics of conglomerate mergers:

(1) The acquisition of businesses in many widely divergent industries;

(2) The operation of these businesses on a highly decentralized management and accounting information;

(3) The possession of few common manufacturing or distribution facilities and the infrequent transfer of products between divisions; and,

(4) The existence of limited joint costs, except for financing and central administration. Unlike the other types of mergers, the stress on this last category (conglomerate) seems to be on diversification and decentralization.

Conglomerate mergers are characterized by a distinct strategy of investment. Objectives of growth, stability and flexibility of sales and profits may be achieved through conglomerate merger. For all practical purposes, even though there are many kinds of conglomerates, the salient feature of each seems to be a vesting of control in a new breed to management.

Studies have shown that over the years, trends in merger activity are on the upswing, yet there seems to be considerable controversy as to the character, structure, objectives and consequences of this business

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5 Stanley Vance, Managers in the Conglomerate Era (New York: John Wiley and Sons, 1971), p. 33.

organization synthesis. By definition we said that a merger is a consolidation of one firm with another. Specifically, it is a union of two or more business enterprises by the transfer of all property and authority to a single organization. Mergers can pose an economic problem, through their effects on the structure and concentration in industry. Structural changes in turn affect the performance, behavior and conduct of the constituent firms.

Concern about the power of large enterprises (which may evolve due to merger processes) has been expressed in many forms. For example, it is argued that the power of large enterprises brings about an unfortunate distortion in the performance of the economic system because it leads to such characteristics as rigidity of prices and relaxation of drives toward maximum efficiency. Modern antitrust laws are directed towards preventing such abuses and unhealthy developments in the economic system. This calls for public action to provide the necessary "blueprint" for a change in business behavior.[6]

Methods of Mergers

(a) A Take-Over - In a transaction where CC is similar to either AA or BB, the merger is called a "take-over." That is one policy control group took over the assets of another, adding them to the assets they already controlled. The purpose of a "take-over" bid may be either to make possible large-scale production and so enjoy economies of scale or to obtain a larger share of the market.

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[6] Ibid., p. 33.

(b) An Amalgamation - A merger is called an amalgamation when CC is a combination of AA and BB on a somewhat equal basis. A merger is said to be a take-over of assets only where the assets acquired were not organized in the form of a separate firm. For example, these are assets bought from firms that are winding up their operations or from government enterprises (which were formally sold to private enterprises), or from divisions of large companies which were not organized as subsidiary companies. A complete take-over means the acquisition of full ownership of a firm, a company or a proprietorship.

In addition to the broad definition, there is also a more concrete and narrow definition of merger. The latter definition is based on the legal provisions which govern the formation and rules of conduct and performance of business enterprises in most countries.

These are statutory mergers or consolidations. In these cases, one or more companies are merged into another or into a new company in compliance with the laws dealing with such transactions of their incorporation.

The terms or conditions of statutory mergers or consolidations agreement must be approved by the shareholders (i.e., a majority of shares of voting stock) of each of the merging or consolidating firms. From the accounting aspects of mergers and acquisitions, the American Institue of Certified Public Accountants uses the term "business combinations" in a general descriptive form and classifies them as "purchases" and "pooling of interests" according to the specific circumstances.[7]

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[7] George D. McCarthy, Acquisitions and Mergers (New York: The Ronald Press, 1963), p. 17.

(c) A Purchase - is described as a business combination of two or more corporations in which an important part of the ownership interest in the acquired corporation or corporations is eliminated.

(d) And a Pooling of Interests - is a combination of two or more corporations in which the holders of substantially all of the ownership interests in the constituent corporations survive in the combined enterprise. In a pooling of interests as compared with a purchase, no new basis of accountability arises. The importance of accounting and tax aspects of business combinations lies in the fact that they influence the form of the transaction and may also adversely affect the interests of one or both parties to the transaction to the extent negotiations may be terminated.

Competition Market Power and the Public Interest

For a capitalist country it is argued that economic and social progress are to be found in the preservation of a predominantly market economy; protection of the public interest lies in the promotion of competition in industry often by means of legislation. The concern is with large-scale economic power and the likely undesirable consequences when markets tend to be monopolized.

What is it that producers, consumers and others want from the economy and especially what is expected of the competitive market economy? First, an economy requires progress in the economical methods of production, and under competition, this means that some take the lead and others follow.

Second, consumers require a variety of products to choose from. In terms of progress it means that the producers are exploring and influencing the customers' preferences and potential preferences, and products evolve in the directions these preferences indicate.

Third, consumers want new products developed which is a necessary correlative of more efficient methods of production. Fourth, society wants the diffusion of the benefits of progress to consumers in lower prices or to those who contribute factors of production in higher real rewards. This involves a progressive sharing of the rewards of innovation.

In addition to the above objectives competition also plays other important roles. Competition implies mobility of productive resources which are needed to the inevitable inequalities in rates of growth in different parts of the economy, and in a growing economy mobility is possible with a minimum of actual shifting of persons or capital.

The importance of competition has been summarized this way:[8] (1) Because the actual level of prices in competitive markets should in the short-run more accutately reflect the influence of demand and of costs and thus in the long-run help guide the flow of capital and other resources toward the most productive possible uses; (2) because the good of competition provides powerful and pervasive incentives for product innovations and product development and for long-run cost reduction, both through improved technology and improved management, these forces make themselves felt in the constant process of product

[8] A view of the Attornery General's Committe in Levin, H.J., Business Organization and Public Policy: A Book of Readings (New York: Rinehart & Co. Inc., 1959), p. 11.

variation, and through the pressures implicit in the fact that competitive conditions offer an open opportunity to new extrants in a particular industry; and (3) because competitive conditions in business should lead to an equitable diffusion of the resulting real income among consumed and factors of production.

However, not all of this quartet of virtues are connected to the functioning of markets in an equally intimate way. However, efficiency and equity in income distribution will result where the competitive market forces bring prices down to costs, while progress will result in attempts by competitors to "build a better matchbox." The competitive system will also help us toward certain more general solid and political conditions concerned with opportunity, mobility and the absence of concentrated power.[9]

At this stage it now becomes necessary for the purpose of applying competition to public policy to distinguish between pure or perfect competition which is an instrument of theoretical analysis; and "workable" competition which is a standard of attainable competition that purports to be more realistic and more relevant to public policy than are theories of pure or perfect competition.

In a perfectly competitive market each seller acts independently as if his own decisions had no influence on any significant market variables such as price, supply, demand conditions, the number of other sellers etc. This is brought about because sellers are many in numbers and individually of insignificant size relative to the total market;

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[9] C. Kaysen and D.F. Turner, Anti-Trust Policy (Cambridge: Harvard University Press, 1959), p. 11.

the product of any seller is a perfect substitute for that of any other; and new sellers enter and old ones leave freely in response to profits etc. In this model economic efficiency is defined in terms of the relations between costs and prices; resources in response to consumer demand are employed in the most efficient manner as a result of the prescribed market structure and the logic of profit maximization.[10]

However, as is well known, the great majority of markets do not fulfill the conditions of the economist's abstract model of "perfect" competition, since many variants and degrees of imperfect competition are to be found in most markets. In some cases the imperfection of competition may partly reflect successful efforts by firms to differentiate their products - to use product features and design, packaging and advertising, to persuade the consumer that what he is buying is significantly different from what the firm's competitors are offering.

Thus, the concepts of pure and perfect competition are tools of theoretical analysis which are not intended and do not constitute a description of reality. As a theoretical model, these ideas give economists means for rigorously exploring the interrelationships of certain specified market forces. They have also helped to make more precise certain selected results centering on cost-price equilibrium, which economists have long concluded, should flow from competition. However, it must be emphasized that pure and perfect competition are wholly theoretical standards in that they are not as such to be guidelines to public policy.

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[10] Ibid., p. 7.

"Workable" Competition

In using economic analysis for purposes of public policy, it is important to view competition and efficiency in dynamic rather than purely static terms. That is, they must be seen in a context of economic change over time, with new products, industries and methods of distribution constantly coming forward and old ones dying off. This implies that if the economist is to help formulate a definition of competition and to lay down a set of criteria that is to be considered worthy of promotion by public policy, then a much more realistic approach is required. The result has been the development of "workable" competition which seeks to provide a method for making necessarily less exact but more practical realistic judgment of actual market situations.

There are many definitions of this subjective idea of "workable" competition as there are wide differences of opinion on its precise characteristics - one group stressing certain structural conditions (number and size of seller), while the second group of economists emphasizing the desired business performance in terms of efficiency and progressiveness; calling workably competitive the market structure that facilitates this. Here we are more concerned with the structural approach since mergers have a direct bearing on structural changes in industry.

Illustrative of the structuralist approach are the following conditions:

(1) Products, though not necessarily standardized, must be so similar that buyers will not hesitate to substitute one for another. Nor must advantages offered by buyers differ enough to make sellers hesitate to shift from one another;

(2) Though buyers and sellers are not equally intelligent or well-informed, market information should at least be equally available to all;

(3) Buyers and sellers must be sufficiently numerous and limited in size as to give them alternative sources of supply and outlets for sales such that their choices may influence price, service and quality. They need not be so numerous and small that none has an appreciable influence on supply;

(4) There must be no collusion between rivals on price, output, markets, etc. Nor must inequality of power and resources or fear of retaliation prevent sellers from competing with each other; and,

(5) There must be no artificial or other handicap blocking the entry or exit of firms and the transferance of resources. [11]

In short, market conditions must provide a substantial number of real alternatives to all, in order to limit the discretionary power of any single buyer or seller - spreading among many this power to influence price and quality. This structural approach has been criticized for being too precise in that it may be cited to justify quantitative ceilings on the size of firms.

Alternatively, the performance group believes that an adequate performance is one where firms use resources economically; operating at an optimum size, at lowest unit costs and a high percentage of capacity, quickly pass on cost reductions to consumers at lower prices; and continually innovate new techniques and processes.[12] Consequently, this group concludes that fewness and bigness of sellers, the existence of dominant firms and even of restraining trade practices may in certain cases facilitate rather than impede growth and efficiency.

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[11] See Clair Wilcox, Public Policies Towards Business (Homewood, Ill.: Richard D. Irwin, 1955), pp. 103-104.

[12] Harvey J. Levin, Business Organization and Public Policy, op. cit., p. 5.

At this stage, it is appropriate to review the different opinions posited by some eminent economists. The underlying factor, however, is that from a prescribed market structure results are forthcoming, which approach the predicted results of the model of perfect competition as closely as could be expected or closely enough for "all practical purposes." Bladen and Stykolt insist that there must be several alternative sources of supply between which the buyer can choose freely; that is there are no long-run barriers to entry so that the established firm's price policy is framed with potential competition from new entrants in mind; that there is evidence of technological progress, new products, new processes, new administrative procedures; that the evidence suggests that the advantages of such progress have been passed on to the public. Such effective or "workable" competition would be "workable" from the point of view of the producer and "effective" from the point of view of society.[13]

According to Stigler, the market is workably competitive where there are considerable number of firms selling closely substitutable products in each market; where there is no collusion between these firms; where the long-run average cost for a new entrant is not materially higher than that for an established firm.[14] Clearly, many industry-patterns in the old world fail to pass these tests.

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[13] V.W. Bladen and S. Stykolt, "Combines Policy and the Public Interest," in Anti-Trust Law - A Comparative Symposium (Ed. W. Friedman), (London: Stevens, 1956), p. 66.

[14] G.J. Stigler, "The Extent and Basis of Monopoly," in American Economic Review, Vol. 32, No. 2, June 1942, p. 1.

Writers, like Bain, would prefer to make inference about the industrial structure from the performance of the industry. Bain[15] would therefore conclude that the structure of the industry is defective where for example a profit-rate is being made consistently above the normal return on investment; where many firms in the industry have grown to a scale outside the optimal range; where chronic excess capacity prevails; where selling costs bear an abnormally high proportion to total costs; where the industry responds slowly to technical changes. However, the great problem of using performance rather than structural tests is that a subjective judgment needs to be made about what is the norms and endless controversy is the inevitable result.

J.M. Clark[16] has pointed out that the best results in terms of industrial efficiency may arise from a structure with moderate number of large, strong and growing concerns with a fringe of smaller specialist manufacturers.

A distinguished antagonist of the traditional conception of competition and the proclaimed virtues of price competition was J.A. Schempeter. In the real world of oligopolies, "effective" competition means "the competition from the new commodity, the new technology, the new source of supply, the new type of organization, etc. - competition which commands decisive cost or quality advantage and which strikes not at the margins of the profits and outputs of the existing firms

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[15] J.S. Bain, "Workable Competition in Oligopoly," in American Economic Review, Vol. 40, No. 2, May 1950, p. 35.

[16] J.M. Clark, "The Orientation of Anti-Trust Policy," in American Economic Review, Vol. 40, No. 2, May 1956, p. 93.

but at their foundations and their very lives."[17a]

While there still exists an assumption that a considerable degree of competition is probably desirable as a means of promoting maximum efficiency and cost savings, it is now realized that under certain conditions of modern industry, degrees of imperfection can result in greater efficiency and thereby savings to the consumer. Schumpeter and Galbraith maintained that for modern industry a high degree of monopoly is desirable; the gains of large size and concentration, notably economies of scale, with consequent reduction in costs, general and administrative efficiency and above all technical progress and innovation with their resultant benefits to consumers, will in their views far outweigh their possible disadvantages.

By this theory it is a big business which enhances living standards for the general public.[17b] Thus modern economic theory influenced by Schumpeter lays stress not on the hypothetical ideal of competition but on the idea of "workable" competition. A discussion of "workable" competition should therefore resolve round the question of the mixture of monopoly with competition which modern industrial conditions make feasible. The aim is to secure as far as possible the benefits of large-scale enterprise without losing the spur of competitive conditions. Nevertheless, how big is big business is a question which concerns measurement and significance of size distribution of firms in an industry or in the whole economy.

From the discussion, we could see a dilemma: long-run competitiveness is necessary to promote innovation and to ensure that the public

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[17a] J.A. Schumpeter, Capitalism, Socialism and Democracy (New York: Harper, 1942), p. 84.

[17b] However, it should be emphasized that not only is there no conclusive evidence but that some economists argue the opposite.

enjoys the cheapness and plenty which is the product of innovation; yet some restriction on competition in the short-run is essential if innovation is to be induced in a system of free enterprise. Admitted, that it is evident that the modern need for "bigness" in industry renders a certain degree of monopoly inevitable, the question arises as to how to decide what amount is desirable or permissible in any given industry, and how to translate what may be a complex formula into terms suitable for anti-combines legislation and administration.

But how much monopoly is compatible with our idea that economic decisions should emerge from impersonal market forces? The question is how much monopoly is tolerable, or conversely, how is it recognizable?

The essential precondition of monopoly (as opposed to the competition of the "perfect" model) is that a firm can significantly affect price by varying its output. This implies an elasticity of demand significantly below infinity with the consequences that the firm can set output such that marginal costs persistently tend to differ from price. The result is that output of the product is too small in relation to demand conditions and the conclusion is that society's scarce resources are misallocated.

Other possible manifestations of monopoly power may include: extortionately high prices and low quality of product by eliminating the penalty which competition involves for inefficiency and inertia, management is inefficient yet leads a "quiet life," restriction of output leads to under-utilities of society's productive potential; the existing inequality in income distribution is aggravated through excessive profits and concentration of wealth; through monopoly's rigid prices, adjustment to economic change is obstructed and industrial instability is identified.[18a]

At this stage, we are faced with two sets of interrelated questions. How do we distinguish between mergers which have primarily a market power impact and those which have an efficiency impact; and where a merger results in both increased market power and increased efficiency where is the trade off? Concerning this question, we will briefly review the problems which arise when we apply micro theory to horizontal mergers and make an attempt to predict the market power efficiency outcome.

Changes in the structure of an industry arising from horizontal mergers are important because of their implications for performance in the industry. A change in structure may increase the degree of monopoly power in the industry with unfavourable implications for performance from the point of view of the public. It is also possible that mergers with their accompanying change in structure may decrease the degree of monopoly power and there is therefore no certain linkage with the public interest in this respect. Additionally, it should be pointed out that mergers which do increase monopoly power in the industry involved may be associated with an increase in the economic efficiency of the industry in so far as costs are concerned as a result of economies of scale or other effects which improve the use of resources. These mergers, therefore, may improve the performance of the industry from the public's standpoint. Moreover, there is a problem of balancing the effects of monopoly and efficiency. For these reasons the implications for mergers for performance are ambiguous.

[18a] F. Machlup, The Political Economy of Monopoly (Baltimore: Johns Hopkins University Press, 1952), p. 73.

The problem of the evaluation of mergers is compounded by the problem of determination of fact. Measurement of monopoly power is a contentious matter[18b] and changes in the degree of monopoly power are hard to determine with any degree of certainty. Also, measurement of changes in the cost levels in an industry are far from simple to ascertain and where prediction is involved the exercise is even more problematical.

Clearly the evaluation of the effects of mergers on the public interest is difficult because it often involves a balancing of favourable and unfavourable effects. The ambiguity inherent in the situation is made more acute by the uncertainty that is involved. Beyond these considerations is the fact that some mergers are in industries which play a significant role in the nation's interest beyond those areas of concern to all industries such as output, costs, prices, and profits.

When a horizontal merger occurs in a perfectly competitive industry, could the results of such a merger be anti-competitive or would we expect economies of scale? Given the usual assumption of a competitive market as one having numerous buyers and sellers, the merger would undoubtedly cause little concern; since the elimination of one firm (competition) will have no significant impact on market power. If the merger is to be justified, it must realize economies of scale, which again given the usual assumptions, appears to be unlikely. If oligopolists merge, then the resulting monopoly could be anti-competitive, but much more will depend on assumptions governing the oligopolists' behavior prior to the

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[18b] See Eugene M. Singer, Antitrust Economics (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1968), Ch. 8.

merger.[19]

What we have done that even in extreme cases, prediction of something definite about performance from mere structural change is

[19] A. Beachman and J.C.H. Jones, "Merger Criteria and Public Policy in Great Britain and Canada," Journal of Industrial Economics, Vol. 19, April 1971, p. 99.

very difficult.

On the other hand, mergers which are economically significant generally arise in oligopolistic industries. But here again, we can predict little about performance from structure unless we make some very restrictive and unrealistic assumptions. In order to overcome the dilemma, we can make a grossly oversimplified proposition like this: "Most markets are not perfectly competitive. When competition is already imperfect mergers will make it more so." Competition should not become more imperfect, therefore mergers should be discouraged.[20]

As competition in theory has always been defined as a market structure, mere structural changes - reduction in the number of competitors which is the most immediate and obvious result of any horizontal merger - become the criterion by which mergers are judged.[21] However, as already stated, it is obvious that any policy supposedly based on the static virtues of perfect competition is doomed to failure. The inadequacies of perfect competition as a guide to policy are quite clear, and we should note that in addition to questions of "second best" income distribution and information conditions, there is theoretical and empirical evidence to support the proposition that resource misallocation in non-perfectly competitive market is likely to be light.[22] Clearly, therefore, in oligopolistic situations micro-models per se do not help in setting up standards by which to judge the market power-efficiency

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[20] Donald Dewey, "Mergers and Cartels: Some Reservations About Policy," in American Economic Review, Vol. 50, May 1961, p. 256.

[21] Beachman and Jones, op. cit., p. 99.

[22] See H. Libenstein, "'Allocative Efficiency' vs. 'X Efficiency,'" in American Economic Review, Vol. 61, June 1960. See also G.B. Richardson, Information and Investment (Oxford University Press, 1960).

division for horizontal mergers.[23]

The critical question to be examined next is to assess whether market power is increased by business mergers, and if so, what part can be attributed to merger and acquisition in promoting high concentration in Canadian and British industry. The approach is illustrative and no attempt at an elaborate explanation of high concentration is undertaken.

Do mergers within a particular industry tend to concentrate control of assets and output in that industry? Markham[24a] has observed that mergers free entrepreneurs to create new firms with new assets. But the fact that they leave the industry and go elsewhere while the number of surviving firms is reduced inevitably means that the total assets in the industry have been concentrated.

It would be a fruitless attempt to attempt an assessment of the effects of mergers on overall concentration in industry. Quite a number of important mergers would have to take place in the already highly concentrated and heavily capitalized industries before the overall level of industrial concentration was affected. And intense merger activity can hardly be expected in industries where only a relatively few small competitors still remain for purchase. Meanwhile, it is possible for "low-capitalized" industries such as foods and textiles to become almost completely monopolized through mergers without significantly affecting the concentration index for manufacturing as a whole.

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[23] See Beachman and Jones, op. cit., p. 100.

[24a] J.W. Markham, "Survey of the Evidence and Findings of Mergers," in Business Concentration and Price Policy (Princeton: Princeton University Press for National Bureau of Economic Research, 1955), p. 145.

Development of Mergers in British and Canadian Industries

Merger developments in many sectors of British industry are known to have started before the last decade of the last century. However, studies have shown, that, despite its early occurrences there was comparatively little merger activity until the end of the Second World War.[24b]

An explanation for the early timing of the merger wave is the development of a broad and strong capital market and the existence of financial institutions which enabled organizers of mergers to utilize this market. The generally favourable condition of business and a rising buoyant securities market make practicable larger and larger units of business enterprise. This in turn permitted the centralization, in one corporate structure, of control of a large part of an industry, and made possible a more effective rationalization of industry output by businessmen. Other factors such as the rate of industrial growth, the rise of technological innovation and the growth of interregional transportation (e.g., railways) are causes which might have assisted in the early consolidation process.

In the period between 1887 and 1906 (Table 1), there was a total of 113 recorded mergers in Britain, affecting a wide range of industries such as textiles, chemicals, iron and steel, liquor and beer, etc. The highest number of mergers seems to have occurred in textiles (34), iron and steel (29), and mineral extraction (18). In the inter-war period, the merger movement that occurred, reflected to some degree the emergence of new leading industries in the years since the earlier period. In certain respects, it represented attempts to restore the industrial

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[24b] Refer to G.D. Newbound, Management and Merger Activity (Liverpool: Guthstead, 1970), Chapter I.

TABLE 1

INDUSTRIAL DISTRIBUTION OF BRITISH MERGER ACTIVITY 1887-1906

Industry	No. of Mergers
Textiles	34
Chemicals	7
Mineral Extraction	18
Iron and Steel	29
Liquor and Beer	14
Tobacco	2
Other	9
Total	113

Source: H.W. Macrosty, The Trust Movement in British Industry (London: Longmans).

concentration achieved at the turn of the century.

The relatively fewer merger activity in this period prior to the second post-world war era (Table 2) indicates that merger activity has not reached a high level. Table 2 shows that with the exception of 1956, with a trough in merger activity, all the other years have shown increases with a peak in 1968. In 1968, there was a total number of 1,433 recorded mergers, the highest in British history for a single year. The unprecedented upsurge in merger activity in the years 1967-1968 has led one writer to comment: "... for the typical firm, merger activity was previously no more than an occasional form of growth, but now it has become the means of achieving an instant increase in size essential for the defence of the market and the industrial position of the firm; and for the economy merger activity was formerly little more than incidental but (now) it has become a major phenomenon of this decade."[25]

According to Jervis, the comparative absence of mergers in the period 1887-1906, in Britain, has been attributed to a number of reasons. The main bulk of industrial activity was still in the hands of family businesses which until 1907 were largely "private" companies.[26a] "For such family businesses 'going public' was often viewed with suspicion, and while it was possible for such businesses to amalgamate into larger units, the process was not as easy as it is for the modern company with its diffused share ownership and fewer family loyalties."[26b]

Although merger activity in Britain did not reach a high level before the end of the Second World War, yet the period presented some

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[25] Ibid.

[26a] F.R. Jervis, The Economics of Mergers (London: Routledge and Kegan Paul, 1971), p. 41.

[26b] Ibid., p. 42.

TABLE 2

NUMBERS OF COMPANIES ACQUIRED IN BRITAIN

Year	No.	Year	No.	Year	No.
1954	275	1959	559	1964	939
1955	294	1960	736	1965	995
1956	246	1961	632	1966	805
1957	301	1962	636	1967	1068
1958	341	1963	885	1968	1433

Sources: 1954-1961: Economic Trends, April 1963, HMSO
1962-1963: Economic Trends, Nov. 1965, HMSO
1964-1966: BOT Journal, Nov. 15, 1968, HMSO
1967-1968: U.K. Financial Press Listings

important features. In certain degrees, it helped to restructure many industries formerly characterized by many small and medium sized firms into those in which one or a few very large enterprises occupied leading positions. A notable example of one merger among many others is the case of the Imperial Chemical Industry (ICI) which was formed in 1926 by an amalgamation of thirty-seven firms in various sections of the chemical industry in Britain.[27a]

Thus, it must be concluded that the high concentration ratios in a number of British industries could be attributed to the role of mergers. Among industries affected were cement, cotton, wallpaper, and tobacco. By 1920, the match industry had reduced through mergers to three largest groups and in 1922, through further consolidations, the British Match Corporation remained as the sole producer.[27b]

It is important to note that there is the tendency for high concentration, once attained, to persist because of the following factors:

(1) stagnation or a decline in trade activity; and,

(2) barriers to entry of new firms.

However, for the great majority of the highly concentrated trades, the long-term trend to demand has been rising, so that the explanation of the maintenance of high concentration must be sought in the operation of the production and market factors restricting entry and limiting the growth of the smaller firms in these trades.

[27a] Ibid.

[27b] See H.W. Macrosty, The Trust Movement in British Industry (London: Longmans, 1907).

At this stage we now turn to some highlights of Canadian experience in merger development. In addition, an attempt is made to examine the significance of American take-overs of Canadian firms.

In Canada, the consolidation movement is widely spread and in almost every section of the economy numerous consolidations have occurred.[27c] The extent to which these mergers have produced monopolistic conditions in any of the sectors of the economy depends on facts outside the scope of this study.

Thus as Table 3 shows, the "pulp and paper" group with 59 consolidations and the "chemicals" group with 54 are probably much more "monopolistic" than the "foodstuffs" group with 81. Nevertheless, it must be noted that the size of the group, the effects of international competition are factors which need to be taken into account before useful conclusions are reached.

In explaining the causes for variations in merger waves, Professor Weldon finds a correlation between major merger movements and common stock prices. "In particular the major movements which centre about peaks in 1910-1911 and 1928 parallel similar movements in stock prices."[28] Weldon argues that the financing of consolidations

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27c See Table 3.

28 J.C. Weldon, "Consolidations in Canadian Industry, 1900-48," Restrictive Trade Practices in Canada 233 (ed. L.A. Skeoch, 1966), p. 234.

almost always requires securities to be issued, at times in exchange for stock or assets, at times for cash with which to purchase stock or assets. Thus, he concludes that great booms in consolidation occur in periods during which conditions for the disposal of stock are abnormally favourable.[29] (See Table 4.)

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29 Ibid., p. 235.

TABLE 3

NUMBER OF CONSOLIDATIONS AND NUMBER OF ENTERPRISES ABSORBED BY SELECTED INDUSTRIAL SUB-GROUPS 1900-1948

Commodities & Services	No. of Consolidations	No. of Enterprises Absorbed
Beverages	45	79
Chemical Products	54	85
Comm. Services	18	33
Cotton & Woollen Yarn & Cloth Manufacture	23	31
Dairy Products	27	67
Electric Power	80	140
Foodstuffs	81	195
Grain Elevator Service	21	42
Grain Mill Products	28	65
Iron, Steel & Products	36	58
Machinery & Equipment	70	93
Meat & Fish Packaging	18	69
Non-Ferrous Metals & Products	65	101
Non-Metallic Minerals	30	66
Paints	12	12
Paper Products	14	17
Pulp & Paper	59	81
Rubber Products	11	15
Shipping Services	15	39
Silk, Rayon & Knit Goods	13	13
Trade & Services	60	112
Wood Products	9	23
Other	58	98
Total	847	1534

Source: J.C. Weldon, "Consolidations in Canadian Industry 1900-1948," in Restrictive Trade Practices in Canada 251 (ed. L.A. Skeoch, 1966).

TABLE 4

NUMBER OF CONSOLIDATIONS IN CANADIAN INDUSTRY 1900-1948

Year	No.	Year	No.
1900	3	1924	9
1901	3	1925	31
1902	2	1926	33
1903	1	1927	46
1904	3	1928	87
1905	7	1929	74
1906	10	1930	44
1907	5	1931	26
1908	3	1932	16
1909	10	1933	18
1910	25	1934	14
1911	28	1935	16
1912	22	1936	12
1913	12	1937	9
1914	2	1938	13
1915	7	1939	10
1916	9	1940	7
1917	9	1941	6
1918	4	1942	12
1919	13	1943	18
1920	15	1944	25
1921	5	1945	30
1922	9	1946	32
1923	18	1947	16
		1948	18
Total			847

Source: J.C. Weldon, "Consolidations in Canadian Industry, 1900-48," in <u>Restrictive Trade Practices in Canada 233</u> (ed. L.A. Skeoch, 1966).

The following tables (5 and 6) show the number of mergers involving foreign companies in the Canadian economy. Between 1900-1948, 16 per cent of all acquiring firms were American while 84 per cent were Canadians. As Table 5 shows, the percentage of American companies never exceeded 21 per cent for each of the sub-periods. From 1948-1966, the share of American acquisition of total Canadian acquisitions increased to about 23 per cent. By dividing the periods into 1948-1959 and 1960-1966, American acquisitions became 15 per cent and 29 per cent respectively, indicating that American merger activity seemed to have almost doubled since 1959. However, 1963 witnessed a decline in merger activity.

Commenting on the decline of American merger activity in Canada, Professor Markham explains that one reason would have been the attractiveness of other markets such as those in Western Europe in the early 1960's, which might have drawn the attention of American firms away from Canada.

Another reason suggested by C.J. Maule is that these might have been an exhaustion of a number of firms for acquisition following a period of extensive take-over activity which ended in 1962. Domestic merger activity was then high which might have reduced the number of firms available for a foreign take-over.

A third reason is that balance of payments considerations in the United States may have mitigated against the outflow of capital required to make foreign acquisitions. Perhaps it could be added that the awareness of economic rationalism by Canadians may have discouraged foreign take-overs. Also, it must be added that foreign ownership resulting from mergers and acquisitions raises a wide range of conflicting issues. It is argued that the presence of foreign

TABLE 5

NATIONALITY OF ACQUIRING FIRMS BY DECADES FOR THE PERIOD 1900-1948

Period	No. Canadian	No. American	Percent Canadian	Percent American
1900-1909	42	5	89	11
1910-1919	120	11	92	8
1920-1929	276	46	86	14
1930-1939	142	34	81	19
1940-1948	129	35	79	21
1900-1948	709	131	84	16

Source: J.C. Weldon, "Consolidations in Canadian Industry 1900-1948," in Restrictive Trade Practices in Canada 264 (ed. L.A. Skeoch, 1966).

TABLE 6

NATIONALITY OF ACQUIRING FIRMS 1948-1966

1 Year	2 Canada Nos.	3 U.S. Nos.	4 U.K. Nos.	5 Other Nos.	6 Total	7	8 1st Acc in Canada by U.S. Firms (3-7)	9 3/6%
1948	26	3	-	-	29	-	3	10.3
1949	20	1	-	-	21	-	1	4.8
1950	21	1	-	-	22	1	2	4.5
1951	30	-	-	-	30	1	1	-
1952	28	4	1	-	33	1	5	12.1
1953	24	5	1	-	30	-	5	16.7
1954	24	4	5	-	33	4	8	12.1
1955	29	11	3	1	44	3	14	25.0
1956	39	7	3	-	49	4	11	14.3
1957	28	10	2	-	40	1	11	25.0
1958	34	8	2	-	44	2	10	18.2
1959	48	11	2	3	61	6	17	18.0
1960	39	17	4	4	63	3	20	27.0
1961	49	18	6	-	77	4	22	23.4
1962	41	23	1	1	65	4	27	35.4
1963	34	7	3	2	45	2	9	15.6
1964	65	24	2	3	93	8	32	25.8
1965	65	38	2	1	108	8	46	35.2
1966	63	31	2	-	98	4	35	32.0
Total	707	223	39	15	984	56	279	22.7

Source: C.J. Maule, Mergers in Canadian Industry 1900-1963. (Unpublished Thesis in the University of London Library, 1966.)

subsidiaries may help raise managerial competence in broad sectors of an economy thus contributing an important element of dynamism to the economy.

Public Policy Remedies

Mergers are not condemned per se, and the choice for public policy is to design appropriate criteria for judging which is which. "A judgment concerning market power is of the essence of merger policy. A policy that forbade all mergers would be nonsensical. But if some are to be permitted and others forbidden, the dividing line must turn on conceptions of market power."[30] And it has been said: "The most fruitful field for the application of a market power standard, however, is merger policy."[31]

Applying the economic or market power concept, there will be two main issues for public policy: (1) should the present degree of industrial concentration be reduced through dissolution? (2) should future proposed mergers be subject to effective government review and regulation?

Dissolution and Divestiture

One possible solution advocated would involve an "unscrambling of the industrial omlet," that is, a policy of dissolution and divestiture.

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30 E.S. Mason, Economic Concentration and the Monopoly Problem (Cambridge: Harvard University Press, 1957), p. 400.

31 Ibid., p. 61.

Opponents of this proposal, have suggested that, where economies of size are claimed and where structural re-organization would involve significant performance losses, the burden of proof should be placed upon the defendants. Doubts would be resolved in favour of reducing market power rather than maintaining performance.[32]

Another view states that, as part of a thorough attack upon excessive concentration, dissolution and divestiture would be the principal means of action in an effort to recover lost ground and clear away existing concentration of power.[33] On the contrary, Weston is doubtful whether the breaking up of each of the four largest firms controlling 80 per cent of output into six or eight small firms would produce more competitive behavior. "Economic theory has not provided an answer to this question either on a prior grounds or by factual data."[34]

Control of Future Mergers

The second of our public policy measures calls for a rigorous control of future mergers as opposed to the above dissolution remedy. Where authority is granted to an administrative body to control future mergers, the need for dissolution as a remedy becomes less. Reducing market power by controlling future mergers has a very important advantage over the dissolution remedy. Many critics view dissolution as having a disincentive effect on the firm's initiative for efficient operations.

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[32] Kaysen and Turner, op. cit., p. 81.

[33] Corwin D. Edwards, Maintaining Competition (New York: McGraw-Hill, 1949), p. 154.

[34] J.F. Weston, The Role of Mergers in the Growth of Large Firms (Berkeley: University of California Press, 1953), p. 90.

However, if the controlling device is the norm, then the question is: How much market power should be permitted by public policy? On this criterion, Edwards has said: "A rule of law should be established which forbids acquisition of any substantial part of the capital assets of a business enterprise ... if the effect will be to increase appreciably the size of a great concern. It would be appropriate to consider specifying a range of acquisitions that would be forbidden unless the enterprise desiring to make the acquisition successfully assumed the burden of proof that the public interest would be served rather than injured thereby."[35]

Another writer recognizing that merger may involve a reasonable possibility of improved technology and increased productive efficiency, and that the structural restraints inherent in merger may be offset by an overall strengthening of the competitive process, has suggested that any merger authorizing body should consider: the number and relative size of firms in the particular industry; the growth pattern of the merging companies; the history of anti-competitive practices in the industry; the intent and design of the acquiring company; the gains in efficiency arising from the merger; the conditions of entry into the industry.[36]

According to Kaysen and Turner, any horizontal or vertical merger where the acquired firm's share of the market is 20 per cent should be prima facie be illegal. Market is defined broadly: "Two products belong in the same market if a small change in price (a product) causes a

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[35] Edwards, op. cit., p. 143.

[36] I. Brecher, "Combines and Competition," Canadian Bar Review, Vol. 38, 1960.

significant diversion in a relatively short time of the buyer's purchases or the sellers' production from one product to another."[37]

They recommended that no action against conglomerates would be necessary if a hard line on horizontal mergers were taken. Their hard-line position on mergers is that, "any expansion of a firm by merger is less competitive in its effects than would be the corresponding expansion by new investment ... new investment adds to supply and capacity; the merger does not immediately, though it may lead to such addition in the long-run."[38]

However, criticism about rules on size have been made by Weston because of their impracticability. He believes that the boundaries of an industry are too difficult to define to apply a rigid percentage figure; that early pioneers would require special treatment; that the economic effect of a stated percentage would vary with the technology of the industry, the nature of demand and cost functions and the relative ease of entry into the industry.[39]

The foregoing discussion has established that if society finds intolerable the wielding of large-scale market power by private individuals and firms, then some measure of control over mergers, as one road to building such market power is required. As a quantifiable measure, the concentration ratio, together with other structural features, provides a guide to the strength of power in the market. The attack upon excessive power must consist in a series of proceedings

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[37] Kaysen and Turner, op. cit., p. 27.

[38] Ibid., p. 135.

[39] Weston, op. cit., p. 97.

against examples of such power. The development of such an attack necessarily involves discovery of standards for determining whether or not excessive power is present or imminent in particular cases.[40] At a later stage in our study, we shall explore the policies of Canada and Britain in dealing with the problems of mergers, and compare the criteria that each has used to determine when economic power is intolerable.

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[40] Edwards, op. cit., p. 12.

CHAPTER II

MOTIVATIONAL FACTORS OF MERGER ACTIVITY

The Concept of the Firm

The motivations or inducements for mergers is perhaps one of the central issues that needs to be explored in a study of merger activity, and there are many questions. Why do mergers take place? Why are there peaks and other times troughs in merger activity? Why are some firms and not others involved? Answers to these and other related questions would add significantly to the understanding of merger activity and further the formulation of clear and logical public merger policy.

For the purpose of this chapter, we shall attempt to formulate answers to the first question: Why do mergers take place. However, before commencing our analysis, it is appropriate to set out some general definitions of the firm, the entity involved in mergers which are the objects of public policy.

In the real world the business firm is both an administrative unit and a collection of productive resources. In the traditional "theory of the firm" in economics, which has been developed for the purpose of assisting in the problem of price determination and resource allocation, the "firm" is simply a "price-and-output decision-maker, while the growth of this firm is nothing more than an increase in the output of the given product.

Where the firm is a growing organization, the firm must be endowed with many more attributes than are possessed by the 'firm' in the traditional theory of the firm. A crucial aspect in the definition of the firm involves its role as an autonomous administrative planning unit, the activities of which are interrelated and are co-ordinated by policies which are framed in the light of their effect on the enterprise as a whole. The constituent members of the central management or policy-making body vary from firm to firm. This body is the highest authority within the administrative framework of the firm and it is responsible for establishing or altering the administrative structure of the firm, laying down general policies and making decisions on those matters where no subordinate executive has been authorized to act or where no clear-cut principles have been set out in advance. The latter category would include all major investment and financial decisions as well as the filling of the top managerial posts.

The significance of this aspect of the firm becomes clearer when one remembers that the firm is also a collection of productive resources, the disposal of which between different uses and overtime is determined by administrative decisions. The physical resources within the firm include both tangible objects - its capital equipment and stock of semi-finished goods, as well as the human resources available - skilled labour, clerical, administrative and managerial staff.

The general purpose of management is to organize the use of the firm's resources - capital equipment and stock of semi-finished and finished goods as well as the human resources at its disposal for the production and sale of services.

Very soon we shall come to find out that one of the motivating forces in some firms is the desire to expand their operations. Although such growth can bring forth greater fruits for the economy, through the benefits offered by large-scale production, there is a basic conflict for society if such growth takes one of two roads open to it.

In general, there are two ways by which a firm can attain the objectives of business expansion. A firm may grow by internal expansion, which includes all growth except that which comes about by absorbing firms or substantial properties from firms with formerly independent existence. External growth on the other hand may take place by the purchase of the assets or the stocks of another company. Expansion of firms raises the possibility of conflict for the public interest. In this study the focus is on the problems of external expansion.

Expansion may mean specialization which itself is associated with greater efficiency in production. Nevertheless, the competition among firms that ensures that the fruits of specialization are passed on to the final consumer of the product is inevitably lessened, where the external route is the selected mode of expansion.[1] Depending upon the relative positions of the merging firms, it is possible for competition to be reduced to the point where the market power of the newly consolidated firm is great enough to preclude the passing on of the gains of increased efficiency to the consumer.

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[1] In Chapter I, it is argued that reduction in competition, depending upon the prevailing structure of the industry, may produce good or bad results.

Recognition of this conflict means that it would be interesting to examine these changes quantitatively, in terms of costs and profits, and that conclusions as to whether or not any merger was in the public interest might be reached by examining the extent to which cost reductions were passed on to the consumer, or by examining the extent to which wages were increased, or by estimating the rise in productivity, or by calculating the effect of the merger on any other factors synonymous with the public interest.

However, such an exercise is beset with difficulties, since not only are mergers a response to a new situation but also it takes time for their full effects to be realized. There are few occasions for the use of this "performance" approach in merger policy, since a comparison of the situation immediately before the merger with the situation immediately following the merger would only be useful if it is assumed not only that in the absence of the merger things would have continued as before, but also that after the merger a new and permanent situation is quickly reached.

The Role of the Firm

On the basis of the foregoing analysis of the firm, we should now proceed with analyzing of the functions of the firm and to account for the role of mergers in the growth and development of such a business organization. Attempt is made to answer such questions as: What is it that motivates the firm? What induces it to grow in size? Why is merger often preferred as the road to larger size rather than some alternative method?

In every sphere of industrial activity, the production and distribution of goods and services are undertaken by large numbers of different firms in separate industries and processes, each supplying through the market. Why, therefore do some of these firms merge with each other? In a way this problem is inseparable from that of why do firms seek to grow in size? The difference lies in the mode of expansion in each case. Generally the reasons advanced for mergers, whether valid or not, rely on the arguments for the advantages of increase in size. However, there are special problems of expansion by merger which will have to be distinguished and separately analyzed.

Thus the motivating forces behind the formation of industrial combinations are complex in form and varied in character. Socio-economic forces which called the combination movement into being are involved and complex and therefore it is not possible to state them as clear-cut causes. Special needs of the promoters in each industry and the economic conditions of the country determine their forms and modes of operation.

Throughout this theoretical appraisal of the motivation of the firm, it is assumed that investment decisions are guided by opportunities to make profit, and that firms are in search of profits. That is, some firms desire to maximize the rate of profits, while others are interested in increasing the market share. And in the "management-controlled" corporation of the twentieth century, the individuals of the co-ordinating team will wish to retain and re-invest these profits in the firm for the purposes of prestige, personal satisfaction in the successful growth of the corporation in order to provide scope for their ambitions and abilities or for the mere love of the game.[2] In this context, dividends will be viewed as a cost to be kept at a level just sufficient to satisfy present shareholders and to entice further capital from the market when required.

The assumption is, therefore, that in general the financial and investment decisions of the firm are controlled by a desire to increase total long-run profits, and there is a marked tendency for the firm indefinitely to retain as much profit as possible for re-investment in the firm. The proposition is that "profits" would be desired for the sake of the firm itself in order to make more profit through expansion.[3]

Assuming that profits are sought primarily for the sake of the firm to re-invest, then an increase in total long-run profits is equivalent to increasing the long-run rate of growth and so "growth" and "profits" become synonymous as the goal of the firm's investment decisions. These particular motivations are applicable to the type of entrepreneur who has been referred to as being "product minded" or as a

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[2] E.T. Penrose, The Theory of the Growth of the Firm (New York: Wiley, 1959), p. 28.

[3] Ibid., p. 29.

"good-will builder."[4] He is concerned with the improvement of his products and the introduction of new products, the reduction of costs, the development of better technology, the extension of markets through better service to customers, etc.

He should be distinguished from the "empire-building" entrepreneur whose product improvement activities will be delegated to other persons in the firm, while his attention is occupied with extending the scope of the enterprise through acquisitions or the elimination of competition by means other than composition in the market. His goal will be the creation of a powerful industrial "empire" extending over a wide area.

The desire to expand will be dictated by both external and internal circumstances of the firm. The external factors may include the following: a growing demand for particular products, changes in technology which call for larger-scale production, special opportunities to obtain a better market position or achieve a monopolistic advantage and defensive measure against changes which could adversely affect the firm's existing operation and against which protection is sought, for example, through backward integration to control sources of supply, diversification of final products to spread risk, or expansion of existing products to preclude the entry of new competitors.[5] Internal motivations to expansion arise largely from the pool of unused productive services, resources, and special knowledge, all of which will always be found within any enterprise.

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[4] Ibid., p. 39.

[5] Ibid., p. 65.

The economies of size is significant when we take into consideration that the larger firm, because of its size, cannot only produce and sell goods more efficiently than smaller firms, but also can introduce large quantities of new products more efficiently.[6a] Economies of size are divided into: "technological" economies which are derived from producing large amounts of a given product in large plants; "managerial" economies result from improved managerial division of labour; "financial" economies reduce unit costs when purchases, sales and financial transactions are made on a large-scale.

As pointed out earlier, the firm wishing to expand its scale of operations, has one of two alternatives: the firm has the option of internal expansion of building new plants and creating new markets for itself; or it can expand by acquiring the plants and markets of already established firms. If growth is considered profitable, then the firm will choose the merger method of expansion only if it is considered more advantageous than the internal expansion on this point. J.F. Weston has included among the motives for merger the desire to achieve economies of large-scale production, distribution or advertising economies, or the financial advantages of large size.[6b] These are of course motives for expansion and not necessarily for the merger method of expansion.

[6a] However, it is not implied that there are always economies related to size.

[6b] J.F. Weston, The Role of Mergers in the Growth of Large Firms (Berkeley: University of California Press, 1953), p. 86.

Merger Activity in Perspective

Before we begin a discussion of the reasons why businessmen might agree to a merger, first we shall explain some of the causes of merger waves. This involves an explanation of relationships between merger waves and historical developments. It is hoped that the explanation would aid the understanding of why there are peaks and other times troughs in merger activity.

In general, factors such as the rate of industrial growth, development of an interregional transportation system, and the development of a broad and strong capital market are important for merger waves.[7] To the above list should be added factors such as the level of technological development and motivations toward market control.

One of the popular explanations of the early merger movement is that it marked a period in the United States' economic development in which retardation of growth set in. It was interpreted that mergers were devices whereby producers could preserve profits in the face of slackening demand and greater pressures of competition. Watkins has described the historical trends to which he attributed the retardation in market growth: the closing of the frontier, the slackening of population growth, the slowing of technological change and the post 1873 secular decline in prices. In his view, these various tendencies converged at the end of the nineteenth century and set the stage of the merger movement which he described as "a centralizing phase in the organization of industrial control in the United States."[8] However, proponents of the

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[7] See Ralph L. Nelson, Merger Movements in American Industry 1895-1956 (Princeton: Princeton University Press, 1959), p. 71.

[8] Myron Watkins, Industrial Combinations and Public Policy (Cambridge: Cambridge University Press, 1927), p. 16.

retardation theory have emphasized that it is retardation in individual industries rather than retardation in aggregate industrial growth that is important in merger behavior.

Another popular explanation for merger movement at the end of the last century is the development of a national net-work of railroads. The development brought about a fundamental change in the nature of markets for goods. Nelson[9] found that the merger wave around the turn of the century occurred during a large and protracted expansion of the railroad system and during a substantial decline in the relative cost of transportation. He also discovered that a considerable part of total 1895-1904 merger activity in the United States in manufacturing and mining took place in those industries in which transportation costs were larger relative to the price of the product.[10]

In another study,[11] Professor Markham in explaining the timing of the first great waves of mergers in the United States, found a correlation between intense merger activity and the period of rapid railroad building and in the 1920's the rise of the motor car and motor transportation and a new advertising medium. He concludes that mergers have undoubtedly come about as adjustments to major innovations having a rapid and pervasive effect on the entire economy.[12]

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9 Ralph L. Nelson, Merger Movements in American Industry 1895-1956, op. cit., p. 88.

10 Ibid., p. 88.

11 J.W. Markham, "Survey of the Evidence and Findings on Mergers," op. cit., p. 181.

12 Ibid.

Another explanation of the timing of merger wave is the development of an organized large-scale capital market. Empirical evidence[13] suggests that changes in the number of mergers per year appear to be especially closely related to the gyrations of the stock market. This implies that major declines in merger activity have usually coincided with stock market slumps. Nelson found cyclical deviations in the number of mergers occurring per year between 1895 and 1954 to be positively correlated with deviations in stock prices.[14]

However, the reasons why merger activity tends to rise with stock prices and tends to decline when they fall are very complex. Nevertheless, it should be noted here that owners of firms expecting eventually to sell out find periods when stock prices are nearing possible peak a particularly favourable time to execute their plans, whereas they may decide to hang on for awhile longer when stock prices are falling. Acquiring firms find funds for acquisition easier and less costly to obtain when stock prices are high and this may dominate their decisions, despite the fact that the prices they must pay to merger candidates are also higher. However, the relative importance of these and other factors governing the timing of mergers is not fully understood and more research is needed in this field.

Specific Motivations of Mergers

We can now examine the specific inducements of the firm to prefer expansion via the merger method rather than by the internal method. The

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[13] See: U.S. House of Representatives, Committee on the Judiciary, Anti-Trust Report, The Celler-Kefauver Act: Sixteen Years of Enforcement (Washington, 1967), pp. 11 and 39.

[14] *Ibid.*

merger technique has the advantage of helping the expanding firm to overcome entry barriers into new fields and to reduce the absolute cost advantages of large sized competitors in its present field of production. Any firm which embarks on a policy of diversification will be at a disadvantage compared to the established firms in the same line of production. Established firms have the relevant patents and tehcnical "know-how;" their market positions will be established and through widely advertised brand names the public will be familiar with their products; they may be vertically integrated which could ensure a readily available source of supplies and distribution channels; new issues of their stock will enjoy the confidence of the investing public; they may be enjoying economies of scale as a result of their own past expansion. Many of these disadvantages may be reduced if the firm can acquire an established going concern.

Plants can often be acquired at considerably less than their reproduction cost. In addition, the firm may also acquire an experienced team of managers, as well as an experienced technical and labour force. Furthermore, new products, new processes, new plants, new productive organizations, patent rights and a valuable market position, all will have been obtained which might otherwise have taken years to build up. Thus, the firm can enter its new market in the preferred position of an established competitor since the entry barriers to some degree will have been surmounted. However, it is not suggested that there is no limit to the process of expansion. The limit to the rate of expansion will be provided by the managerial problems of regulating the relation between the parent firm and its new acquisition, and the problem of working out a consistent general policy. However, the problems of co-ordination and integration are likely to be lighter for the firm where its acquisitions complement or supplement its existing activities partly because of the past experience of its management. "Thus the existing resources of our firm will not only limit the extent to which successful expansion can be effected through acquisition, but will also influence the direction of external expansion."[15]

Financial Considerations

Consideration of the financial aspect of a business is a reason why the external method of expansion is preferred to internal expansion. Problems of financial disadvantages refer to the difficulties which a firm encounters in raising new funds for further growth and expansion. It may be more feasible to finance an acquisition than to finance internal growth. It becomes attractive when the securities of an existing company are selling at substantially less than their book values. The under-evaluation of the publicly traded stock of a firm would result mainly from the lack of knowledge on the part of the investing public of the value of the firm, a lack of confidence in its management, or a discounting of the less marketable stocks for lack of liquidity.

The lack of capital can serve as a barrier to new entrants to a particular field. The desire for a firm to grow and accept challenge is clear. Through growth profits are made; and the profits can be used in many ways: to re-invest in the business, to pay dividends and as a source of funds to maintain the operation of government machinery.

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[15] Penrose, op. cit., p. 129.

Growth has serious implications: It refers to the physical expansion of the business; or it can mean the improvement in product quality as well as quantity of sales. And it could be improving the efficiency of operations and development of a completely new product line or diversifying into other industries. After undertaking growth through acquisitions, the expanded business may appear as a less risky proposition in the eyes of the investing public, because the purchased facilities may have already demonstrated its revenue-earning capacity and the issue of stock in the market may be facilitated as a result of this quickly attained larger size. Butters, Lintner and Cary pointed out in their study of the recent merger movement in the United States that an important motive for acquisition was the desire of the acquisting firm to obtain the working capital of the seller.[16]

However, Professor Markham in describing the waves of mergers in the United States during the period 1897-99 and 1926-29, both of which rose to their peaks with concomitant rapidly rising stock prices, stated: "The most important single motive for merger at the peaks of merger movements seem to have been promotional profits ... Both periods were marked by easy money and a securities-hungry public. This environment gave rise to a new type of entrepreneur - the producer of mergers."[17] The professional promoter of mergers, whose role was often played by the investment banks, issued the stock of the newly incorporated company in return for the plants of the original concerns.

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16 J.K. Butters, J. Lintner, and W.L. Cary, Effects of Taxation - Corporate Mergers (Harvard University, 1951), p. 231.

17 Markham, op. cit., p. 181.

These mergers had one common feature - the whole was greater than the sum of its parts while the difference between the two was the promoter's profits.

New Product-New Plant-New Production Organization

The Butters, Lintner and Cary study indicates that the severity of cyclical fluctuations of a business motivated many firms to diversify into new products by merger. The rationality for adding a new product line is to reduce the effects of cyclical fluctuations which are familiar business characteristics. For example, a manufacturer of building hardware can drop certain slow moving items if he discovers that increasing labour costs have made short production runs unprofitable. To replace these items, he can purchase another firm which for example makes a line of home workshop tools. The reason for the purchase is the belief that new products have a different cycle from those of his own. He may also believe that the existing marketing organization can be used to sell the new products thereby reducing unit sales cost.

Butters, Lintner and Cary, quoted as an example, the McGraw Electric Company, a manufacturer of light household electric appliances, in recommending the acquisition of the Wire Material Company to its shareholders explained: "The line of products of the Company will be considerably diversified as compared with McGraw's present line. This diversification will be primarily in the capital goods field in which McGraw has not participated to any important degree up to the present time. The industry in which diversification will take place is a necessary and important adjunct to the electric utility industry, the expansion of which history has shown follows primarily population growth and industrial development rather than economic fluctuation."[18]

Empirical evidence suggests merger cases where new products were added to a given product-line in order to replace declining products of merchandise with products which had favourable prospects. In other cases new products were needed simply because they could be marketed along with the old ones at no substantial increase in selling expenditures; or because they allowed other savings in overhead costs. Equally important is the fact that acquisitions have been made with the hope of improving the purchaser's competitive position by enabling him to "offer a full line" to customers. This is particularly attractive to smaller firms which are in competition with larger corporations with full product lines.

The existence of excess capacity in an industry may arise for a variety of reasons including a decline in demand, increased foreign competition, overexpansion of the trade in the past or the introduction of new or improved technological methods. During the war years, this phenomenon presented itself in certain British industries such as steel, shipbuilding, flour-milling and textiles and many amalgamations and centralized marketing schemes were carried through with government support and approval, as part of a process of rationalization for stability and progress.[19] Technological change by intensifying this problem of surplus capacity may accelerate the merger process and acquisition, with the result that a convenient way of introducing the

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[18] Butters, Lintner, and Cary, op. cit., p. 225, quoted from McGraw Electric Co., Notice of Special Meeting of Shareholders, July 12, 1949.

[19] J.H. Dunning and C.J. Thomas, British Industry (London: Hutchinson, 1961), pp. 44-47.

new techniques is found with the least disturbance to industry as a whole.

Quota System

Where there are arrangements calling for a division of trade available or for the allocation of scarce raw materials, merger may prove to be the easiest way for the firm to expand its share of the market. In the British Cement, flour-milling and sugar refining industries in the inter-war years, many acquisitions and take-overs were motivated by these privately-organized or officially-sponsored market sharing arrangements.[20]

Also the attitude of a society towards certain business practices, as shown in its anti-monopoly laws, has induced many mergers and take-overs. The 1898-1903 American merger movement, which coincided with a relaxation of incorporation laws, the widening of national markets increasing the marketability of securities was preceded by the passing of the Sherman Act in 1890. Given this expansionist economic climate and the fact that the recent legislation outlawed collusive activity, businessmen sought to engage in practices as one firm and in that which was outlawed when practised by separate entities.[21] Brittan[22] observes: The recent merger activity in Britain's more concentrated industries, such as man-made fibres, oil refining, tobacco and sugar, reached a peak in 1959-61, and may have been stimulated by the fact that the restrictive Trade Practices Act of 1956, while raising a presumption that price-fixing

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[20] R. Evely and I.M.D. Little, Concentration in British Industry (Cambridge University Press, 1960), p. 188.

[21] Weston, op. cit., p. 82.

[22] S. Brittan, The Observer (March 8, 1964), p. 7.

and other restrictive practices were against the public interest, left firms free to combine their efforts through merger.

As mergers generally involve both a buyer and seller, one would expect the factors which influence the seller to be different from those of the buyer. In view of this, we are now considering the motivating factors of a seller in a merger transaction. These considerations have been divided by Butters, Lintner, and Cary into: management reasons, investment reasons and taxation reasons.[23]

Management Considerations

As a firm grows bigger and bigger, top management job may become more complex. A combination of different factors of varying degrees would make it so: increased technological complexity; greater governmental regulation of business practices; difficulties of finding supplies of useful raw materials; and above all rapid improvements in the techniques of management and administration of large firms that are seeking ways to grow further. The hey day of "one man" management is a thing of the past since management is now the job of a team. This is characterized by the managerial revolution of this century, dramatized by the control of large firms by salaried managers.

Mergers motivated by the shortage of skilled management personnel may be classified into three broad groups: (1) Firms too small to afford a well rounded team but too large to be run effectively by few people (usually 2-3). Such firms are usually taken over by companies which

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[23] Butters, Lintner and Cary, op. cit., pp. 205-222.

have an adequate executive group of managers. (2) Many firms previously owned and managed by families. Such firms are usually sold when it becomes evident that the families could no longer provide the managers themselves, or when they could not hire the servies of a qualified executive team. (3) Increased technological complexity of almost every industry, tight labour market and the difficulties of finding inputs during inflationary periods. Bushnell[24] has emphasized that the requirements of modern industrial organizations demand that a successful manager to know the techniques of modern administration including a working knowledge of accounting, personnel management, time and motion studies and market analysis.

In their study, Butters, Lintner and Cary found that management considerations were more important in the sale of smaller companies. The most prominent motivation cited was the desire of the owner-manager to retire and in the usual case, for various reasons, there was the dearth of adequate management succession. Where the owner-manager has most of his wealth invested in the business, he becomes reluctant to expose his family to the financial risks involved in abdicating control of his business in favour of an untired successor.

Investment Considerations

Investment considerations are motivations in merger transactions. The expectation by an owner that his holdings will decline in value for various reasons, either suddenly in the near future or gradually over

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[24] Bushnell, op. cit., p. 366.

the years can lead to a sale. In any case, it may be that the investment motive for sale is simply the normal desire of an investor for greater diversification and improved quality and marketability of his investment holdings.

Taxation

In many merger transactions, tax considerations had generally played a motivating role: Butters, Lintner and Cary found out in their study that taxation was given as a major reason for the sale of many firms. In such merger cases, the importance of taxation will depend on the tax structure prevailing in the particular country, and so the impact of taxation as a motivation for sale will vary with the particular prevailing circumstances. For example, the impact of th4 estate tax on the owners of family businesses will be reinforced by the combined effects of high income taxes. Owners of business wishing to pass on their holdings to their hèirs must accumulate large amounts of liquid assets in order to provide for their estate taxes and for other liquidity needs. The personal income tax can make the accumulation of such funds very costly. The recent sale of Labatt shares to an American brewery provides an example of a sale which was prompted by the problem of finding a large amount of cash to satisfy the succession duty collectors.[25] An undesirable consequence of succession duties and the ensuing sale of Canadian small family business is that in a large number of cases the purchase has been made

[25] The Winnipeg Tribune (February 28, 1964), p. 6.

by foreing interests at a time when Canadians are becoming suspicious of alien ownership and control of their businesses.

Reduction of Competition

And finally, we now turn to the motive which is perhaps the most frequently advanced explanation of merger - merger for the reduction of competition or for market monopolization.

Since merger does not add capacity in the market, such a mode of expansion does not intensify existing competitive conditions as does the direct entry, through internal expansion, of a firm into a new market. In fact, expansion by merger, since no capacity is added, is not entry and no appeal can be made to the generally accepted competitive benefits from entry. Expansion in this way avoids the downward drag on prices that might follow from expanding by building. However, where an industry is "sick" and suffering from "too much competition," merger may be the route chosen to bring more stable conditions to the market. Under conditions of cut-throat competition, manufacturers undercut the prices of each other and thus eliminate each other from the market in order to have a virtual monopoly. Sometimes the competition becomes so severe that no one can make anything out of the trade. At this stage the industrialists realize that to gain survival for all, each must surrender something to the common cause. In this regard the elimination of the wastes of competition thus becomes an impelling motive to the formation of mergers in industry.

Nevertheless, we can find at the other extreme the ambitious "empire-building" entrepreneur who may be seeking monopoly profits through market domination. Through mergers, the revenue curve of this firm may become less elastic and the value of the acquired firm to him would be increased correspondingly. To this entrepreneur, with extensive ambitions to achieve impressive results in a relatively short period of time, the merger route may be the only practical route to his goal.

We can trace the period of mergers for monopoly in the United States (1887-1904) when the great trust, such as Standard Oil, United States Steel and American Tobacco were conglomerated through mergers. In Canada, perhpas the best example of monopoly achieved through merger and other predatory business practices was provided by the match industry and the activities of the Eddy Match Company. To this must also be included the activities of the Electrical Reduction Company of Canada.

Markham was observed that "the path of economic theory and merger literature have rarely crossed,"[26] which has led in many studies to the improper conclusions that mergers have generally resulted in monopoly and that monopoly has been their goal. In conclusion, it must be emphasized that the explanation of merger cannot be a simple monocausal one.

The purpose of this chapter has been to underline the basic driving force behind modern corporate firms - the urge to expand for the sake of the firm. We have seen that external expansion or merger has many advantages to offer the expanding firm over the internal method of growth. However, we have seen that this underlying drive for expansion covers a wide gamut of motivations ranging from a desire to maintain a going enterprise on one hand and on the other to reap the benefits of large-scale

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[26] Markham, <u>op. cit.</u>, p. 143.

production. Merger is an integral part of the competitive business process - the strong absorbing the weak, a useful method for the entry and exit of liquid assets and entrepreneurial talent seeking employment in market areas which are viewed with varyind degrees of optimism.

Take-Over of Canadian Firms by American Firms[27]

We now turn to the motives of take-overs of Canadian firms by American counterparts in the early 50's. Before and during this period American manufacturing firms invaded the Canadian market in two distinct ways: The parent company usually built a branch plant in Canada; or it acquired one by buying shares or assets of an existing Canadian plant or firm. Differences in the general economic environment between the two countries have been suggested as one of the possible explanations. The environment includes such factors as taxation, monetary and fiscal policy, tariffs and the level of economic activity.

It is noted that in the early 50's Canada adopted a tight or restricted monetary policy; and it is suggested that this policy favoured American take-overs in Canada. In addition, it is also suggested that another cause for the increased rate of take-overs by American firms has been the amendment to the Clayton Act by the Celler-Kefauver Act of 1950. This amendment may have forced firms which sought to expand by mergers to seek acquisition in other countries including Canada. On this new policy Professor Markham[28] observed its effects: The new policy will force individual corporations to consider more

27 This is a serious problem in Canada, although legislation was not in effect to deal with it. Also, it is not only American firms that are not involved.

28 J.W. Markham, "The New Antitrust Policy," 30 Law and Contemporary Problems, 1965, pp. 607-619.

seriously the alternatives to the acquisition of domestic companies as means of company growth and product diversification. For the large corporation on which antitrust policy has been turned, the logical alternative to such domestic acquisitions is the acquisition of foreign companies especially in Western Europe. It is argued that this "new policy" might have driven American firms to acquire Canadian firms. However, it can also be said that other forces would have contributed; for firms can always expand where the market opportunities are favourable and in the absence of constraints businessmen can always react to the circumstances.

CHAPTER III

CANADIAN MERGER LEGISLATION

This chapter will provide a brief outline of the historical development of Canadian anti-combines legislation as a background against which merger policy may be seen. It has been observed from the foregoing discussions of the motivations and consequences that mergers can never be considered as per se offences. Some mergers will do little to affect the structure of an industry. In particular cases, the likelihood that a merger will result in detriment to the public through its effects on concentration and competition is very often counter-balanced by possibilities of benefits, with the result that in discussions of mergers, the desirability of a selective merger policy is implicit. At a later stage in the discussion, there will be an examination of some of the reports of the Restrictive Trade Practices Commission and the case law on mergers in an attempt to investigate how effective Canadian merger policy has been.

In contrast to the British approach, Canada has made combines control a matter of criminal law, relying on the legal process and judicial remedy. This implies that all acts prohibited by the legislation are criminal and the offences are punishable by fine or imprisonment. Also in Canada, the participants to a merger are innocent until they are found guilty and the burden of proof lies with the government.

The merger wave at the turn of the century in a number of important Canadian industries such as steel, cement, asbestos, canning and meat-packing gave rise to certain monopolies and near monopolies and led to the demand for legislative action. The Canadian legislation like the United States Sherman Act, which followed in 1890, represented the protest of still predominantly agrarian society against the abuse of economic and political power by industry and business.

The phrase "anti-combines legislation" is a component of two categories of parliamentary sanction - the Combines Investigation Act and sections 411 and 412 of the Criminal Code. As it will be noted later, these statutes (in amended form) date back from 1889 and 1910 respectively.

Each enactment outlaws combinations or agreements among sellers or buyers - where under section 411 of the Criminal Code, the purpose of such agreement is to lessen competition "unduly" or where under section 2 of the Combines Act any such combination has the design or effect of lessening competition and has "operated or is likely to operate to the detriment or against the interest of the public." Thus before the amèndment in 1960, each was in some degree supplementary to and duplicative of the other.

The origin of the Canadian Combines legislation lies in a Select Committee of the House of Commons report of 1889. The Committe found that combinations existed in respect of a number of widely used commodities and services, and recommended legislative action. The Act of 1889 was the result of this legislation and became the parent of section 498 of the Criminal Code making it a misdemeanour to conspire combine, agree or arrange unlawfully;

(a) "To unduly limit the facilities for transporting, producing, manufacturing, supplying, storing in any article or commodity which is subject of trade or commerce;

(b) To restrain or injure trade or commerce in relation to any such article or commodity or -

(c) To unduly prevent, limit or lessen manufacture or production of any such article or commodity unreasonably enhance price thereof or -

(d) To unduly prevent or lessen competition in the production manufacture, barter, sale, transportation or supply of any such article or commodity, or in the price of insurance upon person or property."

Characteristic of the Act was the ill-defined usage involved by employing the terms "unlawfully" as well as "unduly" and "unreasonably" to describe the offence which led to difficulties of interpretation. After various legislative amendments the word "unlawfully" was dropped from the section in 1900; and the wording settled into the form it has retained to the present time.

However, under the Criminal Code there were only a handful of prosecutions and convictions. This was due to the difficulties in securing and marshalling of evidence in combine prosecutions. Moreover, in a number of civil suits, the Courts refused to enforce certain restrictive agreements because they contravened the public policy expressed in the Criminal Code section.

Historical Evolution of Merger Legislation

The first Combines Investigation Act of 1910 was therefore enacted to correct the weaknesses of the previous Act. It sought to supply special administrative machinery to enquire into alleged combines. To a large extent the shape of Canad's approach to mergers was determined in the Combines Investigation Acts of 1910 and 1923, both of which were fashioned almost single-handedly by Mr. MacKenzie King. In this Act, the definition of the kind of "combine" activity to be investigated was couched in a language similar to the wording of the combination offence in the Criminal Code. However, a significant addition of the words "merger," "trust" or "monopoly" was included in its frame of reference.

Sections 2 and 32 of the Combines Investigation Act introduced a qualification that to be "unlawful" the combination, merger, trust or monopoly must have "operated or be likely to operate to the detriment or against the interest of the public, whether consumers, producers or others."

For purposes of the Act, a "merger, trust or monopoly" denotes "one or more persons (1) who has or have purchased, leased or otherwise acquired any control, or (2) who either substantially or completely control, throughout any particular area or district in Canada or throughout Canada the class or species of business in which he is or they are engaged." It is apparent that the law allows a broad scope for interpretation, centering in this instance, around the meaning of both "public interest" and "merger, trust or monopoly." This comprehensive definition was retained in the new 1923 Combines Act which, as subsequently amended, is the law today. Apparently, the vagueness of the clauses of the legislation is an indication that Mr. King had no serious intention against mergers in 1910 and those after. However, an important development by the Act was the principle of investigation and report which has remained a part of the Canadian Combines administration.

In general the legislation did not consider "bigness" per se as bad. Unlike other collusive practices, big business carried with it a possibility of improved technology and increased productive efficiency. Thus to contend that large-scale merger per se contravenes the public interest in competition is to ignore the fact that, under certain circumstances, the structural restraints inherent in merger may be offset by an overall strengthening of the competitive process.

Skeoch points out that in introducing the bill MacKenzie King was careful to indicate that there was no attempt being made to legislate against combines, mergers and trusts as such, the whole intention being to prevent those large combinations of wealth which were disadvantageous to the public. The Minister went to great lengths to emphasize the advantages to be expected from large combinations of capital in promoting research and reducing production and distribution costs. "There was, obviously, no hostility to monopoly or near-monopoly, per se. Incipient monopolies or market control, unless abused, were of no concern; on the contrary, they were to be welcomed for their assumed dynamic advantages."[1] The wording of the 1910 Act was similar to that of section 498 (later section 411) of the Criminal Code. Also, it carried forward a provision (which had originally come into the legislation in 1897) for the application of tariff action to combat monopolistic action.

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[1] L.A. Skeoch, "Merger Laws and Issues in Canada," in Mergers, Consolidation and Big Business (Ditchley paper, No. 31, 1970), pp. 62-63.

Nevertheless, the new legislation was ineffective and was lost sight of in the problems created by the onset of the first World War. The two outstanding weaknesses of the legislation were: (1) No permanent agency was established to enforce it; and (2) individuals were reluctant to set the complicated and costly machinery of investigation into action. Again, although the legislation was never tested in the Courts, there was some doubt as to its constitutional validity, since it did not fit the classic definition of criminal legislation in the sense of being a general condemnation entailing some sanctions.

The inflation which followed the end of the war called for a different approach to the problem. The 1919 Board of Commerce Act thus came into being to repeal the 1910 Act. A Board of three members was appointed to administer the Combines and Fair Practices Act to determine whether a combination was being operated "to the detriment of or against the interest of the public." The Board's powers included cease and desist orders (non-compliance was an indictable offence), power to regulate prices, profits and prevent witholdings of goods if the sellers were unsatisfied with price set by the Board. In the Act a combine was defined as one which operated or was likely to operate to the detriment or against the public interest and included "mergers, trusts or monopolies" and the relation resulting from the purchase, lease or other acquisitions by any person of any control over interest in the whole or part of any business of any other person. The Act was found to be unconstitutional due to the fact that control of prices of necessities could not be upheld under the heads of criminal law.

However, it is to be observed that the legislation corrected two of the main weaknesses of the Act of 1910: namely the absence of a continuing enforcement authority and the initiation of investigations only on the application of interested private individuals.

The Act of 1923, which took the place of the 1919 legislation, repaired the defect of the 1910 Act by providing for a permanent Registrar to administer the Act. The Registrar was enpowered to make preliminary enquiries into suspected combines upon direction of the Minister or formal application of six persons, or on his own initiative. A decision after the preliminary enquiry that a formal investigation was necessary meant that the case was entrusted to a special commissioner. As already pointed out, the comprehensive definition of combine, mergers, trusts and monopolies of previous legislation was retained, but no administrative power to order the cessation of activities was provided for.

A number of investigations were commenced under the Act of 1923, but the effect of the depression contributed to a search for other methods of controlling business practices. In 1935, legislation, comparable to the 1919 experiment, was enacted and purported to give an administrative tribunal the power to regulate the operation of combines by administrative direction. Again, these provisions were declared ultra vires of the Federal Parliament.

During the period of the war time control of the economy anti-combines activity was suspended, but was undertaken again after the war. In 1950, the MacQuarrie Committee was appointed to review the anti-combines legislation and recommended such changes as would "make it a more effective instrument for the encouraging and safeguarding of our free economy." Certain suggestions were made by the committee, not the least of which was the recommendation to abolish resale-price maintenance, which was given immediate effect. The Report also advocated the division of the functions of investigation and report between the Director of Investigation and Research responsible for initiating inquiries and gathering evidence, and the Restrictive Trade Practices Commission, an independent tribunal created to appraise the evidence so gathered and make a report to the Minister of Justice. These changes were duly incorporated in the Combines Investigation Act of 1952. The Act provided for a Director of Investigation and Research and for a Restrictive Trade Practices Commission (not more than three members). No new prohibitions to strengthen the merger and monopoly provisions were introduced in the Act except for action against price discrimination which was prohibited. Section 498 of the Criminal Code was amended to section 411 (later section 32 of 1960 Act).

The Combines Investigation Act 1960

The law relating to the control of mergers is found in the Combines Investigation Act of 1960. This law unlike its British counterpart is part of the criminal law. Thus, it is an indictable offence to form a merger in non-service trades whereby competition is or is likely to be lessened to the detriment of the public interest. As we saw earlier, the main stream of anti-combines legislation in Canada between the Acts of 1923 and 1960 was duplicated in two separate enactments, each of which prohibited the same set of offences; but attached to it seemingly different standards of legality. The Criminal Code prescribed actions illegal if done "unduly," while the Combines Investigation Act if done "to the detriment or against the interest of the public." This created difficulty for the courts, on the question of whether "unduly" and "to the detriment of the public" was meant to convey the same or different meanings. As for mergers, the offence was of being "a combine" by way of a "merger, trust or monopoly" and this offence appeared only in the Combines Investigation Act and therefore was subject only to the criterion of public detriment.

Criticisms of the anomaly led to the amendment in 1960 of the lesislation. It is now an offence to be a party or privy to a merger or monopoly as defined in the legislation.[2] Among important changes in the legislation is the transfer of section 411 of the Criminal Code, i.e., the section having to do with restraint of trade to the Combines Investigation Act (1960). Section 411 of the Code, which prohibits conspiracies in restraint of trade became section 32(1) of the Act. But section 2 of the Act which had previously contained the definition of a "combine" which included agreements, mergers, and monopolies was dropped. The word "trust" was eliminated and previous definitions of "merger" and "monopoly" was split up into separate definitions for "merger" and "monopoly."

These new definitions are covered in sub-sections (e) and (f) of the new section 2. It is worth the while to note that before the

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[2] S.33 of the Act provides: "Every person who is a party or privy to or knowingly assists in, or in the formation of a merger or monopoly is guilty of an indictable offence and is liable to imprisonment for two years."

amendment in 1960 a merger was prohibited if it "has operated or is likely to operate to the detriment or against the interest of the public." But under the 1960 amendments a merger is prohibited if the result is that competition "is or is likely to be lessened to the detriment or against the interest of the public." Section 33 also declares illegal "monopoly" within the meaning of section 2(f), that is, a situation where one or more persons substantially or completely control throughout Canada or in any area of Canada the class of business in which they are engaged, and where they have operated or are likely to operate such business to the detriment of the public. These provisions of the Act are considerably less effective than the conspiracy section in restraining monopolistic tendencies in markets characterized by a few sellers or a single seller.

Commenting on these offences, Gosse in 1962 stated: "The success of the merger and monopoly provisions of the Act as an effective regulator of competition in Canada has been negligible. There has not been a single recorded conviction in respect of a merger since the offence was created in 1923. In the four prosecutions dealing with mergers, the Crown has failed on each occasion to satisfy the court that the Act has been violated.[3]"

In examining the present merger provisions of the statute, those cases under the now-repealed "combine" offence may be relevant to shedding some light on what the courts have considered is or is not detrimental to the public interest, and they should indicate to what extent the

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[3] Richard Gosse, The Law on Competition in Canada (Toronto: Carswell, 1962), p. 140.

judiciary considered the case law on the Criminal Code section (now section 32(1) of the Act) had a bearing on "combines" prosecution under the Act. What these cases say in these respects will, presumably, determine how the "new" merger requirements of the statute will be interpreted. "Merger" now means the acquisition or control of the business of a competitor whereby competition is or is likely to be lessened to the detriment or against the interest of the public. Unlike previous legislations, it is now only those mergers that lessen competition to the detriment of the public that are offensive.

Of special interest in the 1960 provision was an injunction provision allowing court's power to dissolve an offending merger of monopoly without the necessity of obtaining a conviction. A change in terms of procedures also occurred in that proceedings could be instituted to the Exchequer Court of Canada which had the general effect of moving the cases immediately into a single, specialized court to hear competition policy cases. However, the power to dissolve a merger has as yet not been used; indeed, it has never been used in the history of the legislation.

In Britain, it is the government through the Board of Trade which refers merger cases for investigation to an administrative tribunal - the Monopolies Commission. The final decision on issues of the public interest is made in the House of Commons, where the Commission's reports are debated. Unlike the Canadian legislation, it is the British Parliament which gives some statutory direction as to what is or is not in the public interest.

The Court's Interpretation of the Public Interest

The state of the Canadian Combines law in many respects owes a great deal to the fact that the Supreme Court has leaned on the common law of England in interpreting the legislation. This has been due to a number of factors which include the tradition and rule of precedent; and the lack of adequate statutory direction by parliament on the meaning of "unduly" and of what was to be contrary to the public interest.[4]

But how have the courts viewed the question of the public interest in merger cases? Has the bench examined the actual economic advantages or disadvantages to the public of each "combine" that has been brought before it?

In most cases, the courts have interpreted "detriment to the public" in the merger and monopoly sections in the same way as they have interpreted "unduly" in conspiracy cases; that is, they have not been concerned with actual economic detriment or benefit in particular cases. Gosse points out: "The per se rule has been adopted and any consideration of the effect, in fact, on the public interest of any price arrangement, merger, or monopoly has been irrelevant."[5]

Up to the present time, the courts have felt that the purpose of the legislation has been to protect the public interest in the common law right of the individual subject to enter into competition with his fellows, and that they believe that the public interest is only affected when the object or effect of a merger is to suppress competition.

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[4] S.32(1)(c) of the Combines Investigation Act, 1960.

[5] Gosse, op. cit., p. 184.

The uncertainties regarding the interpretation to be given to the public interest have been reflected in two merger cases to come to court. In R. v. Canadian Breweries, McRuer, C.J.H.C. declared that the words in the public interest provision, "... for the purpose of the prosecution ... have substantially the same meaning as the word "unduly" as used in its context in section 411 ....[6]

Justice McRuer concluded that the merger had not conferred on the accused the power to carry on its activities without competition, or substantially without competition.

However, in the case of R. v. British Columbia Sugar Refining Co., Mr. Justice Williams agreed with McRuer's analogy in the Canadian Breweries' decision in calling the code cases to assist in the interpretation of the Act. Williams, C.J.Q.B. said:

> "... the Crown in this case must not only establish that as a result of the mergers, the accused acquired the "power" referred to ....: It must also establish excessive or exhorbitant profits or prices. The Crown has not attempted to establish exhorbitant profits; its attempt to establish exhorbitant prices fails." [7]

He added that the Crown must also establish a virtual stifling of competition. In other words, according to the courts in particular cases, a merger must virtually eliminate competition before it becomes "undue" and also to establish a specific detriment.

The weight of judicial opinion in Gosse's view is that all that matters is whether competition is suppressed. Gosse considers that

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[6] R. v. Canadian Breweries (1960) 33 C.R. 1 at 6.

[7] R. v. British Columbia Sugar Refining Co. (1960) 32 W.W.R. at 633.

that the lack of sophistication of the courts will in this respect not be improved until parliament gives some satisfactory direction as to what is or is not in the public interest.[8]

Application of the Merger Provision

Up to the recent past, the application of the merger provision had not been successful and in view of this merger, policy has recently been under review in Canada.[9] One reason for the ineffectiveness of the legislation as evidenced from the courts' decisions suggests that the courts, as already pointed out, were more concerned with the existence of monopoly than with lessening of competition. There has not been a single reported conviction in respect of mergers since the offence was created in 1923.

At this stage, it is necessary to remark that after the Crown lost both the Sugar and Beer cases, it becomes apparent that the Director of Research and Investigations and the courts were using different criteria in merger cases. For example, in the Beer case, the Director alleged that the arbitrary elimination of competition by Canadian Breweries deprived the consuming public of benefits which otherwise might have flowed from the normal interplay of competitive forces. Thus the Director concluded that the public is deprived of opportunity to choose from a wide and diversified range of brands, types and qualities of beer. The Director charged that in general the merger and closure activities by Canadian Breweries were monopolisitc in their nature and were not in the public interest.

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[8] Gosse, op. cit., p.

[9] The Economic Council of Canada for a time was investigating the whole of the Canadian Combines Legislation.

As the court's decision shows none of the above criteria was relevant to the case.

In the Sugar report, the Director had focussed on three main criteria: (a) the relevant market share which extended the dominant position of British Columbia Sugar Refinery thereby eliminating the competition of its most important rival in the Western market; (b) the economic effects such as economies of scale, cost reductions, as the acquisition of substantial interest in Manitoba Sugar may remove the downward pressure on prices and costs formerly executed by competitive forces, etc., and (c) the fate of new and established firms in the industry. However, as the court's decision showed, none of the above criteria was considered as enough evidence for a conviction.

However, in an effort to acquaint the business community fully with the range of factors considered by the Combines Branch in assessing a merger, the Director, in his 1966 Annual Report, published the following guidelines (criteria) that would be relevant:

1. Is there a sensibly defined product for which there are no close substitutes?

2. Is there evidence that a substantial market is likely to be affected by the merger and is capable of fairly unambiguous definition?

3. In the absence of competition among domestic suppliers, is there evidence in the form of a substantial tariff or statistics showing that only a small proportion of the market is supplied by imports, that foreign suppliers cannot be looked to, to protect the public?

4. Is there reasonable assurance that there is no significant government regulation?

5. Is there evidence that existing concentration ratios are high or that there is a large size differential between the acquiring company and its rivals?

6. Is there evidence that the barriers to entry in the industry are high or that they will be raised by the merger or that new firms have not in fact entered the industry for some significant period of time?

7. Is there evidence that competition remaining in the market is likely to be ineffective?

8. Does the acquiring firm have a history of growth by merger or a history of coercive predatory action or any other anti-competitive behavior?

9. Is there any evidence of intent to reduce competition or to dominate the industry?

10. Is there any likelihood that there will be foreclosure of an important market or source of supply to firms unconnected with the acquiring firm?

11. To what extent is there evidence of a real possibility of increased efficiency via economies of scale or transfer of assets from incapable into capable hands?

12. Is there direct evidence of detriment such as excessive profits or price enhancement following the merger?

Nevertheless, whether these criteria have been applied in such a way as to justify the claims that the Branch was going to take a radically different line from the courts is questionable.

With the background of issues and problems involving merger legislation and its application, three most important merger cases will now be reviewed. Two cases were lost by the Crown. The first case was Regina v. Canadian Breweries Ltd. (the Breweries or the Beer Case), and the second was Regina v. British Columbia Sugar Refinery Co. Ltd. (the Sugar case). The Breweries case was the first prosecution of its kind in Canada which was based solely on the operations of the accused as a merger.

Two basic pronouncements arose from those decisions:

(a) that in order to prove that a merger has operated or is likely to operate to the detriment or against the interest of the public it must be shown that its effect is the virtual elimination of competition, i.e., a virtual monopoly;

(b) that this detrimental effect must flow from the merger itself and not from any collateral agreements or acts which might have been entered into or done by the acquiring company without reference to the merger.

The Report Concerning an Alleged Combine in the Manufacture, Distribution and Sale of Beer in Canada

The first major decision concerning mergers under section 32 of the Combines Investigation Act was made in 1960 by the Supreme Court in Ontario. It was a classical example of a "take-over" bid. The purpose of a take-over may be either to make possible large-scale production or to obtain a larger share of the market. This court's decision which established that there is no merger problem under the Act unless the fusion of firms creates a monopoly situation was taken in R. v. Canadian Breweries Ltd. Two developments have helped shape the present structure of the Canadian Brewing industry. In the first place, the industry may be regarded as a regulated one since provincial governments have the statutory right to control conditions under which beer may be sold. Secondly, due to a series of mergers since 1930, the structure has been changed, from one of numerous relatively small producers to one where there are three dominant manufacturers. These operate on a multiplant basis in most of Canada.

In 1955, the Commission reported on an alleged combine (by way of a merger, trust or monopoly) in the manufacture, distribution of sale of beer in Canada. The process started in 1930 when Canadian

Breweries was incorporated for the express purpose of acquiring small breweries in an attempt to dominate the industry in southern Ontario. Thus the Commission expressed that this was a deliberate program designed to place the company in a dominant controlling position in the brewing industry.[10]

Between 1948 and 1960 Canadian Breweries had also extended its operations by acquisition to Quebec and Western Canada. In Quebec the company acquired the multiplant firm of National Breweries which was the largest producer there. Through its controlling interest in Western Canada Breweries Ltd., a holding company controlling five breweries and maintaining a substantial financial interest in four others, the influence of Canadian Breweries Ltd. had spread to Western Canada. The five breweries controlled by Western Canada Breweries Ltd. accounted for a third of all sales in Manitoba, Saskatchewan and British Columbia. As the table shows, such expansion made Canadian Breweries Ltd. the dominant firm in the industry by 1955.

TABLE 7

CANADIAN BREWERIES LTD.[11]

Area	Capacity	Production	Sales
Ontario and Quebec	64%	59%	60%
Canada	51%	48%	49%

[10] Report concerning an alleged combine in the manufacture, distribution and sale of beer in Canada, 1955 (15-16).

[11] Ibid., p. 3.

The expansion had reduced the number of the chief competing producers in Quebec from three to two; and in Ontario, Canadian Breweries controlled more than half of capacity, production and sales. Furthermore, internally the company had decentralized its operations into national brand divisions (Carling, O'Keefe, Bradings and Dow) which ended its policy of local brand mortality. This development in the industry caused the Director of Research and Investigation to allege that Canadian Breweries Ltd. was a 'combine;' and it was pointed out that Canadian Breweries generally paid excessive amounts for merged firms: "... has not been confined to those which were desired primarily for the purpose of assimilating them into the merger, but extended to plants which were desired primarily for the purposes of removing them as competitors." The policy of acquiring and closing down of firms, and the high advertising expenditures incurred by the company, restricted competition, and heightened the barriers to entry. In addition, Canadian Breweries had prevented competition further by other devices such as market-sharing and price-fixing arrangements with the remaining competitors.

Canadian Breweries Ltd., "by reason of the substantial control that it has acquired over the brewing industry in Canada; by reason of the manner in which it has been exercised and is likely to be exercised," constituted in the eyes of the Director a "merger, trust or monopoly" which either substantially or completely controls, throughout any particular area or district in Canada or throughout Canada, the class

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[12] *Ibid.*, p. 4.

or species of business in which he is or they are engaged.[13]

The gist of the company's defence to these charges was that the mergers were carried out with full knowledge of the provincial authorities; provincial control of the brewing industry was sufficiently extensive to preclude detriment to the public; increased concentration of output in the industry was a natural development dictated by consideration of productive efficiency, reduction in the number of competitors meant more competition, not less, the large surviving breweries being better equipped to sustain a vigorous rivalry; and Canadian Breweries had performed a public service by reducing excess capacity and raising standards of marketing for the entire industry.

In its conclusion as regards to the public interest, the Commission found public detriment in the following respects: The mergers were objectionable because of the purpose behind it then and the methods adopted for bringing them about; by reason of the planned program and consequent arbitrary elimination of competition, the consumer public was deprived of the benefits which otherwise might have been expected to flow from the normal interplay of competitive forces of the market, more particularly from the competitive activities of the breweries thus artificially removed from the market; the public had been deprived of opportunity to choose from a wide and diversified range of brands, types and qualities of beer, the number of brands acquired in Ontario having been reduced from some 150 to only 9.[14]

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[13] Combines Investigation Act, 1960, s. 2(f).

[14] Report concerning an alleged combine in the manufacture, distribution and sale of beer in Canada, 1955, p. 101.

In the Commission's views, it was Canadian Breweries' merger program and not natural economic development which produced the increased concentration in the brewing industry. The overriding point for the Commission's conclusion was that Canada Breweries' acquisitions constituted a clear-cut historical pattern of intent to monopolize. In the Commission's findings, the mergers and closure activities were monopolistic in their nature and not in the public interest. Thus the company was charged of being a combine by way of merger, trust or monopoly for acquiring control over, or an interest in 37 other corporations in the brewing industry to the detriment or likely detriment to the public interest.[15]

The Judgment

Due to lack of applicable jurisprudence under the Combines Investigation Act, Chief Justice McRuer referred to the meaning of "unduly" in section 498(1)(d) of the Criminal Code as having substantial jurisprudence (later 411(d)) as used by Justice Cartwright in the Howard Smith Paper Mills Ltd. v. The Queen (1957).[16]

In quoting Justice Cartwright, McRuer said:

> "... in essence the decisions referred to me to hold that an agreement to prevent or lessen competition ... becomes criminal when the prevention or lessening agreed upon reaches the point at which the participants ... become free to carry on activities virtually unaffected by the influence of competition ... (that) ... parliament is taken to regard as indispensible protection of the public interest; that it is the arrogation to the members of the combine to carry out their activities without competition which is rendered unlawful; ... the relevant

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[15] 33 C.R. 1 at 2.

[16] This case was a combination or agreement and not a merger.

> question becomes the extent to which the prevention and limitation is carried out and not the economic effect of the carrying out of the agreement." [17]

Thus Chief Justice McRuer established the following principles for judgment: (1) the enactment is for the protection of the specific interest in free competition; (2) all agreements which, if carried into effect, would prevent or lessen competition unduly are illegal; and (3) in deciding whether the agreed limitations on competition are undue the court does not consider the advantages to be gained by those that are parties to the agreement, nor is the court called upon to be a judge of what the economic welfare of the public may be from time to time.

Chief Justice McRuer thought the language of Cartwright could not be interpreted to mean that the trial judge looked at all surrounding circumstances and decided whether the agreement was an undue restriction on competition.

"I think it was made quite clear that the legal meaning to be attributed to the word unduly is a question of law. As I interpret Cartwright's language, it means this: If the agreement in question when carried into effect would give the parties to it the power to carry on their business virtually without competition, the agreement would be an agreement to unduly lessen competition."[18] McRuer went on to state that for the purpose of the prosecution before him, the words "have operated or are likely to operate to the detriment or against the interest of the public" in the Combines Act was basically the same as

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[17] Howard Smith Paper Mills Ltd. v. R (1957) S.C.R. at 426.

[18] R. v. Canadian Breweries Ltd. (1960) 33 C.R.

"unduly" in the Criminal Code (s. 411).

Referring to the operations of the accused, Chief Justice McRuer said that the merger has not entirely put the accused in a position of monopoly power in either Quebec, Ontario or in any part of Canada. The share of the market enjoyed by the accused in Ontario rose from 11.2 per cent in 1931 to 60.9 per cent in 1958. Concerning this development, McRuer had this to say: "I think it is a fair deduction from these figures that the growth of the accused in the market is due partly to the acquisition of its competitors but in considerable part to an aggressive sales policy."[19] Nevertheless, he concluded: (1) that the closing of plants acquired by the accused has not had the effect of diminishing supplies of beer in Ontario; and (2) the acquisition of plants did not have the effect of giving the accused a monopoly or a substantial monopoly in the market.[20]

With respect to the pricing policy in the industry, McRuer stated that the object of the Combines Act is to protect the public interest against the enhancement of prices that will likely flow from combines as defined in the Act. It matters not whether they arise out of agreements, mergers, trusts or monopolies.[21] Since the prices for beer were set by the Ontario Liquor Control Board which by definition were assumed to be in the public interest, for the merger to operate against the public interest, it must have prevented the provincial body from exercising its power to protect the public interest with respect to prices.

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[19] Ibid.

[20] Ibid.

[21] Ibid.

Finally, Justice McRuer pointed out areas of competition in the market left open to competitors. These include taste, services, and packaging. The evidence shows that in these limited areas competition between the accused and others in the industry is without restraint.[22]

On the basis of his findings, McRuer asked: "Has it been proved beyond a reasonable doubt that the merger has conferred on the accused the power to carry on its activities without competition, or substantially without competition?;"[23] "Has it been proved beyond a reasonable doubt that the merger has conferred on the accused the power to control the market so that the provincial authority in the exercise of its duty in fixing prices cannot protect the public interest?"[24a] Since for both questions there was a negative answer, McRuer rendered a verdict of not guilty.

It should be pointed out that although price control for the protection of the public interest may not be questionable in law, yet in economics there may be doubt that such control is in fact protecting the public interest. For example, although retail prices are uniform, for regulation or negotiation to protect the public interest, the price that must be fixed or negotiated is the price the brewer receives for his product and not the price paid by the consuming public. Jones pointed out that provincial authorities can fix retail prices and not protect the public interest if all they are doing is adding a standard mark-up to the price the brewer quotes as wholesale, but exerting no influence over this quoted price.[24b] Therefore, a distinction is necessary between retail

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[22] Ibid.

[23] Ibid.

[24a] Ibid.

[24b] See J.C.H. Jones, "Mergers and Competition: The Brewing Case," Canadian Journal of Economics and Political Science, Vol. 33, 1967, pp. 551-568.

price and the price the brewer receives. And the Crown argued that in Ontario the retail price was set by the Brewer's Warehousing Company, the Liquor Control Board merely fulfilling a rubber stamp. Thus the operation of the provincial Liquor Boards do not dampen market power, since the dominant position of the "big three" enables them to setting prices.

Furthermore, Justice McRuer's reliance on non-price competition in the brewing industry among the "big three" puts emphasis on the conduct of firms, rather than on the structural aspects. Nevertheless, it must be understood that because of the structural change, entry barriers became high as a result of the influence of sales promotion and the control of distributive channels by the dominant firms. Thus, it can be concluded that the position of established firms is unlikely to be eroded by entry, so that taking into account the position "within" the market and negative effects of regulation, it is unlikely that their positions can be effectively challenged.

The Report Concerning the Sugar Industry in Western Canada and a Proposed Merger of Sugar Companies

The second report to be reviewed is the Report Concerning the Sugar Industry in Western Canada and a Proposed Merger of Sugar Companies (1957). The transaction was a "purchase" since British Columbia Sugar Refinery bought over shares from individual shareholders. It deals with the proposed acquisition of the Manitoba Sugar Company Ltd., by the British Columbia Sugar Refinery (B.C.S.R.). Before the inquiry started, the British Columbia firm had acquired a substantial amount of the shares. B.C.S.R. and its wholly-owned subsidiary Canadian Sugar Factories each refined cane sugar and beet sugar respectively. Together they virtually controlled the sale of sugar in Western Canada. In fact, this group was the only Canadian suppliers in British Columbia and Alberta and, until 1953, virtually the only Canadian suppliers in Saskatchewan. B.C.S.R. was located in Vancouver.

In Manitoba, the only refiner was the Manitoba Sugar Company Ltd. which specialized in beet sugar. It occupied a strategic market situation for both eastern refiners and B.C.S.R. Each of these markets had developed a rigid price structure for its products. It was pointed out by the Commission that because of the presence of Eastern and Western refiners in Manitoba and Saskatchewan markets, this would help keep competition alive there. And Manitoba Sugar Company as the third factor in the area kept alive a considerable amount of competition to a degree disproportionate to its mere size. As a result of increased capacity and production by 1953, the Manitoba Sugar Company increased its sales in Saskatchewan by 7 per cent of the total. In Saskatchewan, B.C.S.R. and its subsidiary were the dominant suppliers; while in Manitoba, the market position of suppliers were as follows:

TABLE 8

Year	B.C. Group	Manitoba Sugar	Eastern Refiners
1950	9%	51%	40%
1951	19%	47%	33%
1952	17%	53%	30%
1953	27%	51%	23%
1954	23%	54%	24%

The industry received some protection from Canadian tariff structure, particularly to refined sugar. Another feature of the market was the basing point system, used by B.C.S.R. with Vancouver as the basing point.

Concerning the merger, the British Columbia Sugar Refinery gave the following reasons for its action:

(1) That the firm had surplus funds and thought the acquisition would be a good investment; and,

(2) It would enable the firm to meet the increased competition from the eastern refineries which was expected to result from reduced freight rates on the completion of the St. Lawrence Seaway. [25]

Notwithstanding this, the Director of Research and Investigation alleged that the proposed merger was a combine within the Combines Investigation Act and "which has operated or is likely to operate to the detriment or against the interest of the public." He explained that the opening of the St. Lawrence Seaway, together with increased production in Eastern Canada, would encourage increased shipment of Eastern sugar into Manitoba. And that the effect will be to force Manitoba Sugar to seek outlets further west and making it a still more important competitor in relation to B.C.S.R. He argues that the elimination of Manitoba Sugar Company as an independent entity would prevent the increased competition. He reiterated that the acquisition of Manitoba Sugar by B.C.S.R. would remove the downward pressure on prices and costs exerted by Manitoba Sugar and would protect the price level already insulated from competition to an unusual degree by the basing-point system and the tariff.

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[25] Report Concerning the Sugar Industry in Western Canada and a Proposed Merger of Sugar Companies, 1957, pp. 163-167.

In the light of the above arguments, the Commission found "... that the proposed merger should be renounced. We believe that the public interest would best be served if Manitoba Sugar operated as an independent company with no share interest in it or control over its hold, directly or indirectly, by any other Canadian suger refining company."[26] The Commission was apprehensive about the large-scale shift in market share which would result, since the new enterprise would be the only supplier of sugar in British Columbia, Alberta, Saskatchewan, and would control about 75 per cent of the market in Manitoba. Thus the Commission in its conclusion stated that: "... the control of Manitoba sugar by B.C.S.R. has the effect of removing competition between the two companies on a price basis and that this is likely to lessen competition in Manitoba and Saskatchewan to a degree which would not be in the public interest ... that the control of Manitoba sugar by B.C.S.R. will close off for the future any opportunities for the public to benefit from lower prices brought about any competition between B.C.S.R. and Manitoba Sugar in the Saskatchewan market."[27]

The Judgment

The trial of British Columbia Sugar Refinery took place in Manitoba before Williams, C.J.O.B., who subsequently delivered a judgment acquitting the accused. British Columbia Sugar Refinery was indicted under two counts: (1) For acquiring control over or interest in the whole or part of the business of the Manitoba Sugar Company; and (2)

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[26] Ibid., p. 183.

[27] Ibid., p. 182.

for substantially or completely controlling the sugar markets in the Western provinces of Alberta, British Columbia, Saskatchewan and in part of the province of Manitoba, thereby contravening the Combines Investigation Act.

In the Sugar Refining case, the reports of the Restrictive Trade Practices Commission differed from the decisions of the courts. The Commission had condemned the acquisition of a beet sugar refiner, The Manitoba Sugar Company, the sole refiner of sugar in Manitoba by the British Columbia Sugar Refining Company, the sole refiner of cane sugar in Western Canada. The Commission concluded that the acquisition had removed competition between the two companies on a price basis which was likely to lessen competition in Manitoba and Saskatchewan to a degree that was not in the public interest. While Eastern refiners competed in Manitoba, the Commission considered that the elimination of competition in that province between the Manitoba and British Columbia Refiners would significantly lessen opportunities for competition in the Manitoba market.

The judge disagreed with the Commission's findings and asserted that there was no economic reasons "except perhaps the effects of over-production" to prevent Eastern refiners entering the field of sugar refining in Manitoba at any time. In addition, he minimized the territorial position of the accused because he considered sugar as a world commodity with a world production and price.

Here it is proposed to summarize the gist of the court's main arguments which led to an acquittal. The judge established the following principles to support his arguments: (1) Not every agreement to prevent or lessen competition is declared an offence. The elimination of competition must be undue; (2) it is not the motive of the merger that is relevant but its effects, i.e., whether a monopoly situation was reached and other specific detriments - exhorbitant profits and high prices; and (3) the public is entitled to the benefit of free competition.

The following points were made by the court:

(1) The accused have not been charged with fixing or enhancing prices nor have they been charged with preventing or lessening of competition;

(2) No agreement was made between B.C.S.R. and Manitoba Sugar to limit competition since purchases of stocks were made from individual stockholders and this did not imply any conspiracy;

(3) Higher prices were not due to the merger and that price fixing procedure had long been carried out before the merger. And this had nothing to do with the merger;

(4) The court is interested in the effects of the merger and the phrase "are likely to operate" are related to a specific act done at a certain fixed time;

(5) The merger had nothing to do with the basing-point system and that the price of sugar is a world price and that sugar is a world product; and,

(6) On the question of eliminating competition, the court disregarded the plea that it is an offence for a company to acquire another corporation for the purpose of eliminating competition. The court rules that the merger did not reduce or limit the productive capacity of the refiners in Manitoba and no attempt was made by B.C.S.R. to monopolize the control of the productive capacity of Manitoba Sugar.

Thus in his ruling, Williams, C.J.O.B. said: "... the Crown in this case must not only establish that as a result of the merger, the accused acquired the 'power' referred to in the cases under ... the Criminal Code: It must also establish excessive or exhorbitant profits or prices. The Crown has not attempted to establish exhorbitant profits; its attempt to establish exhorbitant prices fails."[28]

He added: "The Crown must also establish a virtual stifling of competition." Thus according to Williams, C.J.O.B., the prosecution must, in order to prove "detriment to the public" in merger cases, show firstly: that competition has been "unduly" lessened according to the case law in section 32(1); and secondly, that excessive or exhorbitant profits or prices result. What Justice Williams in fact did was to make the condition that the detriment must flow from the merger (not collaterol acts) and the effects of the merger was important. The application of this double standard led Gosse to make this comment: "More is required of the Crown in a merger prosecution than under section 32(1). In a merger case it is not to be presumed that virtual monopoly will enhance prices. Thus the possibility of there being a conviction for a merger detriment to the public becomes less likely."[29]

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[28] R. v. British Columbia Sugar Refining Co. (1960) 32 W.W.R. at 633.

[29] Gosse, op. cit., p. 192.

Generally, the courts have looked upon the interest of "the public, whether consumers, producers or others," as the public as a whole. It is the public as an abstract entity that is entitled to the benefit of free competition while this overall position of the public is used as the criteria. However, in the Sugar Refining case, Williams, C.J.O.B., viewed the question of the public interest largely from the viewpoint of the "producers" and he considered that "producers" meant beet-sugar growers rather than refiners.

In a compressed form, the above is a review of the substance of the judicial interpretation of the public interest in merger cases. We shall briefly consider some of the implications of the above cases. The courts by not wishing to be called upon to be the judge of economic welfare have indeed done so by determining that only those mergers which completely eliminate or virtually eliminate competition are combines and therefore prohibited. The net effect was to set the standard of elimination of competition at a very high level. Second, the conclusion one must come to is that the courts have not used or do not have an adequate definition of competitive behavior. Free competition as commonly used may refer to a wide range of market structures, short of monopoly and where there are no agreements among competitors.

The purpose of this synopsis of the work of the Restrictive Trade Practices Commission in the merger field has been to point out the fundamental problem for anybody having to pass judgment on a particular merger. The Commission has recognized that under some circumstances the structural restraints inherent in a merger may be offset by an overall strengthening of the competitive process. The problem then for the Commission has been to determine in each investigation how far the economic data on market concentration and market structure warrant an inference of a decline in competition sufficient to affect the public interest adversely. Where the Commission found that the public interest was not adversely affected, this has implied that the merger resulted in significant gains in efficiency on economy which otherwise would not have been realized and in the transfer of such gains in price, quality or service to the public.

As we have seen, the Commission's approach to mergers implies that attention has been focused on at least three general bench marks: (1) The scope of the relevant market. In no case has the relevant market been identified without care (in beer it was defined as regional); (2) It involves around a weighing of economic facts concerned with compensatory costs, reductions and productivity gains. Some economic facts such as economies of scale (in beer), accessibility of new firms, competitive imports (sugar), and the volume of capital required for modern efficient operations, etc. were generally considered by the Commission; and the third bench mark concerns the expansibility and accessibility of old and new firms respectively.

Nevertheless, the Commission has inevitably been criticized by some writers. It has been suggested that in merger cases, "the Commission's discussion has been narrow and has not adequately explored the basic economic issues. Like the court, it has generally confined itself to the consideration of the evidence presented by the Director and the opposing parties."[30] It may be that earlier reports lacked

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[30] G. Rosenbluth and H.G. Thorburn, <u>op. cit.</u>, p. 103.

economic analysis, especially that concerning the beer industry. And if the Commission's "orientation has remained legal rather than economic,"[31] it is maintained that this has been the consequence of the criminal setting for anti-combines in Canada and a lack of clear definition of the public interest by parliament.

The Canadian Breweries case could have been a landmark in Canadian jurisprudence. Actual detriment to the public in general respects had been found by the Commission resulting from the merger, while the court would not consider these actual injuries to the public, but was only concerned with whether or not the effect of the mergers was to give the accused a monopoly. The only form of public injury that was relevant was the possible damage to the "public interest in free competition." As already noted a similar decision was arrived at in the Sugar case.

From the courts' decisions, the implication is that the courts have adopted a legal interpretation of "competitive behavior." To the judiciary free competition has meant freedom to compete and thus freedom is based on the Common Law rights of every subject to carry on his trade. This implies that free competition does not deal with market realities but with the legal aspects of conspiracy. So long as there is an attempt to limit "competition" by agreement, it would appear that a condition of "free

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[31] W.G. Philips, "Canadian Combines Policy - The Matter of Mergers," in The Canadian Bar Review, March 1964, p. 90.

competition" prevails.[32] This certainly is a flaw in operating combines legislation from a legal framework of conspiracy. Also there is no analysis of the economic effects in terms of economic efficiency etc. According to the courts, the public is at all times entitled to the benefit of absolutely free and unrestricted competition and that any merger (or combination) that seeks to destroy competition is criminal, whether or not in the particular circumstances of the case the public interest might be better served by such a combination. As pointed out in an earlier chapter, a horizontal merger may limit competition but it may also contribute to increased efficiency or shifting of assets into more productive use, and even though competition is reduced, yet it may be to the public's advantage.

It has been argued that the present situation of Canadian competition policy with respect to mergers provides a good illustration of an area where it has proved impossible within the confines of criminal court procedure to provide the sort of explanation of complex economic phenomena that would adequately satisfy the protection of the public interest. The reliance on criminal law has been a serious shortcoming of the Canadian anti-combines legislation but as Rosenbluth notes, the 1960 amendments, providing for a court order to dissolve a merger or monopoly without conviction, there may be a certain non-constitutionality involved here providing for the institution of proceeding by information as well as by prosecution and providing these cases to be heard by the Exchequer Court's use of effective

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[32] L.A. Skeoch (ed.), Restrictive Trade Practices in Canada (Toronto: McClelland & Stewart Ltd., 1966), p. 34.

remedies. However, it is to be noted that no one can be tried in the Exchequer Court without the consent of the accused.

He also makes the appeal that there be interaction and co-ordination between government policies in various fields such as tax structure which will affect concentration and mergers, low interest rates by the Bank of Canada and extension of credit by the Industrial Development Bank will encourage small businesses, while a tight money policy will favour large firms with adequate internal sources of finance.

The Electrical Reduction Company of Canada Ltd. (ERCO)

To conclude this chapter, we shall briefly review the case of the Electrical Reduction Company of Canada Ltd (known as ERCO) in its bid to acquire Dominion Fertilizer Ltd. The case is selected because the market involved is characterized by oligopoly features, and also ERCO is a subsidiary of an international company.

ERCO is a wholly-owned subsidiary of Albright and Wilson Ltd. of the United Kingdom. ERCO was a producer of certain chemicals, and during the period 1953-1966, ERCO was in the position at times of being the sole domestic seller, and at other times one of the few sellers of these chemicals in the Canadian market.

In 1970, ERCO was convicted on many counts because of its activities in the industrial phosphates markets including a merger with Dominion Fertilizer Ltd. It acquired control of a potential rival - Dominion Fertilizer Ltd. and held a monopoly in the market for industrial phosphates in Canada which operated or was likely to operate to the detriment of the public.

In 1970, ERCO pleaded guilty on three counts to violating the merger and monopoly provisions of the Combines Investigation Act and was fined a total of $40,000. The company pleaded not guilty to two counts of merger and monopoly offences in the business of manufacturing or dealing in sodium chlorate and these charges were dismissed.[33]

Industrial Phosphates

The Commission found that ERCO took steps to protect its position in the domestic market for industrial phosphates as sole Canadian supplier of many industrial phosphates etc. The Commission further discovered that very large firms - Palmolive, Procter & Gamble, etc. - bought about 80 per cent of ERCO's products of industrial phosphates. Thus their bargaining power as buyers and their easy access to foreign supplies cushioned them against monopoly abuses.

The acquisition of Dominion Fertilizer Ltd. was one of a series of moves by ERCO to protect its monopoly position in industrial phosphates. In 1957 Dominion Fertilizer Ltd. announced its intention of manufacturing both of agricultural and industrial phosphates. ERCO feared that if Dominion Fertilizer Ltd. began manufacturing phosphoric acid, Canadian Industries Ltd. (CIL) would take similar steps. If that was allowed, then CIL would quickly start manufacturing industrial phosphates, thus bringing three producers in the industry, rather than one - ERCO.

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[33] R. v. ERCO. Supreme Court of Ontario. Reasons for judgment of Mr. Justice Stark on sentence at Toronto on January 12, 1970; order of prohibition.

To avoid this situation, ERCO persuaded CIL bo buy triple superphosphate from them (ERCO) and also bought over Dominion Fertilizer Ltd. Following the conviction of ERCO for illegal merger and monopoly, the Supreme Court of Ontario granted an order of prohibition as provided in the Act. ERCO was prohibited from continuing or repeating the offences. Among other things, the order also specifically prohibited the corporation, or its directors, employees or agents, from entering into contracts with competitors regarding selling prices or allocation of markets in industrial phosphates. It was further forbidden to impede the entry of any potential competitor into the business of manufacturing or supplying industrial phosphates. For a period of 12 years ERCO was prohibited from entering into agreements lasting more than one year for supply of sodium tripolyphosphate. However, no attempt was made to dissolve the merger of ERCO with Dominion Fertilizer Ltd.

Sodium Chlorate

Until 1959, ERCO was the only producer of sodium chlorate in Canada. In 1959, Standard Chemical Ltd., a subsidiary of Pittsburgh Plate Glass Co. of the United States, began to produce sodium chlorate for sale and three years later Dryden Paper Co. began to produce sodium chlorate for its own needs. Although the Canadian tariff was not a major barrier to entry, yet in all the years under review, except 1959, imports were insignificant and even in that year ERCO supplied 93 per cent of Canadian needs.

Hooker Chemical Corporation was one of the two largest American producers of sodium chlorate. Its plant at Niagara Falls, New York was the closest to ERCO's central Canadian market. In 1956, Hooker acquired Oldbury Electric Chemical Co. which until then was a subsidiary of Albright and Wilson. After this deal ERCO and Oldbury for a time continued to exchange technical information. At the same time Hooker which was an important customer for chemicals products sold by ERCO, also shared some facilities with ERCO at Vancouver. This relationship facilitated the exchange of price and market information between the two companies.

The relationship also influenced ERCO's policy of refusing to enter the American market for sodium chlorate. ERCO was wary of possible retaliation in the Canadian market by Hooker and other American producers. Thus Hooker refrained from offering chlorate in Canada. Again, due to an undertaking between ERCO and Hooker, on the level of prices, other American producers were unlikely to sell chlorate in Canada at lower prices than they charged their American customers who they fear might request the same concessions.

Many of the moves and counter-moves which ERCO made in order to protect its position in the market for sodium chlorate in Canada are examples of behavior in an oligopolistic market. ERCO was alert to any move by a possible competitor that might affect its position in territory which it considered its own market, and was equally alert to possible effects on competitors of its own moves. In some instances, attempts were made to limit price competition, or to compete on a basis other than price. The fact that the charges against ERCO with respect to the market for sodium chlorate were dismissed by the court may well support the evidence that the present competition law is inadequately designed for bringing oligopolistic practices under public control.

What conclusions must be reached? From our discussion, we must conclude that merger jurisprudence in Canada is at the crossroads. Both the Beer and Sugar cases illustrate how difficult it is for the Crown to obtain a conviction in a merger case. By making mergers, under certain circumstances, a criminal offence which requires proof beyond reasonable doubt, Canada made certain that these circumstances would be strictly drawn and made as objective as possible. Although Canada is in possession of a strongly-worded statute, pertaining to mergers, she is virtually without an enforceable merger policy. Furthermore, the Commission and the courts seem to be working at cross purposes, since the legislation failed to define the offence unambiguously, the judiciary remains rigid in its thinking, while the Commission and the judges do not apply the same set of criteria. The Commission and the courts each has a different standard of evaluation of the public interest.

However, in the final analysis, the legislation has been based on the judicial conception of the public interest in free competition. Thus that interest has only been legally interferred with the judiciary have held, when the object or effect of an agreement is to virtually eliminate competition.

Gosse argues that if prosecutions, on the other hand, are to continue, in all cases where there is sufficient evidence to support a prosecution, what is the point of having the Commission come to conclusions that can have no bearing on the outcome of the case? One cannot but wonder if there is a need for both the Commission and the courts to review restrictive arrangements.[34] He goes on to suggest

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[34] Gosse, op. cit., p. 279.

that if the broader concept of the public interest is to be adopted, it is submitted that one of two things should be done: (1) Either the courts should be directed by parliament to consider the public interest on a wide basis as has been the case with the Restrictive Trade Practices Court in the United Kingdom; or (2) the Commission should administer the controls, the present jurisdiction of the courts being removed. Alternatively, it would be suggested that an administrative tribunal be set up to exercise the present jurisdiction of the courts on combines legislation.

CHAPTER IV

THE BRITISH MERGER LEGISLATION

Economic Background

The following analysis will present the British approach to mergers against the general setting of monopoly control and restrictive practices legislation. It shall trace and offer some explanation of the evolution of British competition policy from pre-war period to the stage which has been reached when legislation on mergers was enacted.

Chapter II included a description of the history of concentration in British industry from the beginning of the twentieth century. In the last decade of the nineteenth century rationalization of British industry was taking place whereby the re-organization of the industrial structure was fostered and encouraged through industrial combinations as a means of securing economies of production and distribution. The government itself was initiator and even organizor of various restrictive practices which included price-fixing, quota and market-sharing schemes ....[1]

A number of other factors contributed to increased concentration in British industry from 1935 onwards. The dislocation and disturbance of the war years left a permanent mark on structure of many industries, particularly the grain milling, tin plate, building bricks and textiles finishing trades.[2] Among the more general factors affecting concentration

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[1] Alex Hunter, "Competition and the Law," Manchester School, January 1959, p. 54.

[2] The Economist, May 14, 1968, p. 467.

technological changes took pride of place and contributed to increased concentration in many areas of industrial activity.

Richard Evely and I.M.D. Little, in their Concentration in British Industry, made a case study for the period 1935-1951 of the degree of concentration in some industries - particularly in trades where concentration increased. A broad conclusion that can be drawn from their study is that while the number of units was decreasing, the gross output, net output and employment ratios increased - which suggests increased concentration in the period under review.

The connection between concentration, industrial structure and monopoly power has been summed up this way: Economic theory suggests that concentration ... is an important determinant of market behavior and market results. Ceteris paribus monopolistic practices are more likely where a small number of the leading firms account for the bulk of an industry's output than where even the largest firms are of relatively small importance. Hence in the explanation of business policy, the characteristics of an industry expressed in the concentration index are likely to play an important part. This relation to the degree of monopoly has motivated most of the empirical studies involving the measurement of concentration.[3]

Such changes as had occurred were noted by the authors of the 1944 White Paper on Employment Policy, in which the government pledged itself to take appropriate action to check practices which may bring

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[3] G. Rosenbluth, "Measures of Concentration," Business Concentration and Price Policy, a report of the National Bureau of Economic Research, Special

advantages to sectional producing interests, but work to the detriment of the community as a whole.

However, as Evely and Little point out, the degree of monopoly, if the harmfulness of monopoly is to be measured solely by market power, cannot necessarily be equated to the degree of concentration. This will depend on other factors, such as the nature of the industry and the degree of competition remaining. The motives for mergers will be of significance also: in the British field, Evely and Little draw a distinction, which could be significant for anti-trust purposes, between amalgamations involving a large number of firms and by several price competition (generally to pattern of the depression fears); mergers between firms which were already relatively large; and piecemeal acquisition by one or more firms until they obtained a position of dominance in their trade, either as a single-unit monopoly, or as dominant firms in an oligopolistic situation.

Historically, there has not been the same dogmatic belief in Britain in the evils of monopoly power as found in the United States since monopolies were bestowed on such companies as the East India Company, as long ago as the Elizabethan era, through Royal Charters. The mere existence of monopoly power has aroused no great protest, but what has been viewed with concern has been the possible abuse of such power.

As it will soon be discovered, despite the continued trend towards combination in British industry, combines in Britain were not subject to any significant degree of legislation until after World War II; mergers and monopolies, in particular, were completely unregulated, since they did not fall within the scope even of the common law provisions.

Perspective on Legislation

Throughout the law on monopolies and restrictive practices there runs a basic conflict. On the one hand, the right of every member of the community to carry on any trade or business that he chooses and in such a manner as he thinks most desirable in his own interest, with a corresponding obligation not to interfere with another's freedom; and on the other hand, the freedom to contract, which implies the freedom to combine with some against others and the freedom "to contract in restraint of this freedom."

Starting from the premise that all contracts in restraint of trade were against public interest and consequently void, the common law of England gradually introduced the issue of reasonableness. The desirability of enforcing certain contracts in restraint by trade was first recognized in connection with convenants to protect the value of intangible property which had been sold. Hence, a convenant which restrained the seller from competing with the buyer, within a given radius and for a certain period of time, was considered reasonable and held by the courts to be enforceable. Over the years a wider range of cases came before the courts and the principles governing the enforceability of contracts in this field became clearer.

In contracts between firms it became established that the firms themselves were the best judges of their own interests and of what was reasonable as between themselves. In theory, the courts still considered the "reasonableness" of contracts in the light of the public interest and would hold a contract to be unenforceable if they believed it to be calculated to produce a pernicious monopoly and to enhance prices to an unreasonable extent.

The legal concept of "conspiracy" refers to an act, otherwise lawful, which becomes unlawful if two or more persons combine to take action with intent to injure; and the injured party has a remedy through civil action for damages or an injunction. For example, the use of collective economic power to drive a rival out of business by means of persistent undercutting would look like wilful damage, while an embargo on supplies to competitors would seem to be almost certainly a conspiracy on which action could be taken. However, at the peak of laissez-faire sentiment in the latter half of the 19th century, there emerged the interpretation that such actions "did not pass the line which separated the reasonable and legitimate selfishness of traders from wrong and malicious acts."[4] Thus the public policy developed that however servere the damage sustained by a third party, as a result of any of the above actions, no liability was attached, unless the person or companies concerned combined wilfully or maliciously to damage. The respondent need only demonstrate that the predominant motive of the combination was to protect or promote legitimate trading interests and the case was secure.

A ruling of some interest was that which precluded evidence by trade, technical or other expert witnesses of actual or likely economic consequences flowing from an agreement. The feeling of the courts was

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[4] Hunter, op. cit., p. 54.

that they were not suitable bodies to deal with matters of this kind.

On this issue, Professor W.A. Lewis has suggested that the courts took the view that not only had they "no legal power to suppress monopoly" but that monopoly might be presumed to be in the public interest.[5] And there are many instances where judges have suggested that competition is not in the public interest.[6]

In addressing themselves to the public policy involved in contracts in restraints of trade, the courts have thus conferred in effect the fiat of the common law upon industrial trusts and combines and trade associations and upon contractual arrangement tending to reduce competition. Agreements to rig tender, tying clauses, exclusive dealing arrangements, agreements to share-out trade in a particular region and agreement not to compete, agreement to restrict output and so on have all been adjudged to be "reasonable" restraint of trade.

The general feeling that "when the question is one of the validity of a commercial agreement for regulating their trade relations entered into between two firms or companies ... the parties are the best judges of what is reasonable as between themselves;"[7] and the belief that the regulation of prices and supply by combines and trade associations may be part of the general price which has to be paid for ensuing a relatively stable level of trade and employment has rendered the common law and the doctrine of the restraint of a trade quite useless as a public safeguard

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[5] W.A. Lewis, <u>Overhead Costs</u> (London: 1949), pp. 160-162.

[6] <u>Hearne</u> v. <u>Griffin</u> (1815) 2, 407.

[7] <u>W.W. Salt Co</u>. v. <u>Electolytic Alkali Co</u>. (1914) A.C. 471.

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against the abuse of monopoly power.

During the inter-war years a number of official reports were published in Britain which pointed out the possible dangers to the public interest from the concomitant growth in restrictive agreements. It is important to examine the reports of the more important committees, as they provide a useful mirror of public opinion and in certain instances, they were instrumental in shaping public attitudes towards the issues upon which they were instructed to report. Public hostility towards suspected war-time profiterring on the part of organized industries, and fear of at the rapid expansion of restrictive arrangements, undoubtedly influenced the government to act.

The terms of reference under which the committees operated emphasized the importance of the export trade to the well-being of the British economy. The two inquiries affected in the immediate post-war period substantiated the belief that trade associations had expanded both in number and in influence during the 1914-1918 war. The committees were convinced that one reason for this expansion was the desire to restrict competition and to control prices. However, these developments were not condemned on dogmatic grounds. The committee on Commercial and Industrial Policy after the war recommended a rapid development of trade associations in British industry, arguing that combination for marketing, especially in the export field, was not only desirable but inevitable. On the other hand, the committee was quick to point out that "... we are far from suggesting unrestrained competition is necessarily desirable in all cases and we recognize that combination with

[8] P. Guenault and J.M. Jackson, The Control of Monopoly in the United Kingdom (London: Longmans, 1960), p. 15.

a view to its limitation while naturally welcome to the producer may not always be to the ultimate advantage to the consumer."[9] However, it readily acknowledged the danger that combines might adopt undesirable practices, exploit the consumer and injure the national interest.

A similar view was taken by the committee on trusts. Both committees recognized the need for continuing government investigation of the activities of combines and trade associations and recommended the establishment of investigating machinery - but neither of them recommended the type of legislation which had been used in North America.

In 1929, the Balfour Committee reported and observed the tendency for the alleged growth of monopoly and discussed the argument for its control.[10] However, the committee's suggestions went no further than a proposal for establishing an investigatory tribunal; and rejected anti-trust laws and thought that any machinery for controling prices or interfering with business conduct stood little chance of acceptance.

What is evident from these reports is the inability to agree that monopoly and restrictive practices constituted any grave danger to the public or that any general anti-monopoly legislation was justified. However, it was admitted that some action should be taken, presumably action that seemed appropriate to the particular situation. Hence, the recurrent suggestions, which were never acted upon, for appointing investigatory tribunals.

The Second World War accelerated the growth of monopolistic and restrictive practices and the first attempt was made in Britain at

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[9] Report on Commercial and Industrial Policy, CMD 9035 (1918), para. 165.

[10] Report of the Committee on Industry and Trade, CMD 3282, (1929).

controlling monopolies in spite of the attention the problem had received over many years. This delay in legislation may have been partly attributed to the depressed condition of Britain's trade during much of this period, when the desire to control monopoly was weakened by depression and overshadowed by a succession of urgent problems, and the consequent fears of uncontrolled competition. And it must also be in part attributed to deep-rooted belief that beneficial control could not be based on any sweeping generalizations regarding monopoly. All that seemed to exist was a conviction that potentially dangerous situations should be investigated and dealt with, not in the light of any dogmas that might exist but according to the merits of each particular case.[11] Thus in the post-war period, when the need for action was recognized, the measures adopted appeared to follow closely the recommendations made by many of the committees that considered the problem in the inter-war years.

The first indication that action was to be taken in modern times to strengthen the laws against monopolies and restrictive practices was seen in the White Paper on Employment Policy.[12] The government stated that in the post-war period, both employees and employers would have to abandon restrictive practices in order to create an expansionist economy and full employment and continued: Employers, too, must seek in larger output rather than higher prices and reward of enterprise and good management. There has in recent years been a growing tendency towards combines and towards agreements, both national and international, to divide markets and to fix conditions of sale. Such agreements or

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[11] Guenault and Jackson, op. cit., p. 24.

[12] White Paper on Employment Policy (HMSO 1944), CMD 6527.

combines do not necessarily operate against the public interest; but the power to do so is there. The government will therefore seek power to inform themselves of the extent and effect of restrictive agreements, and of the activities of combines, and to take appropriate action to check practices which may bring advantages to sectional producing interests but work to the detriment of the country as a whole.[13]

The White Paper was published at a time when the war had fostered the growth of new associations and consolidated the position of those in existence. In addition, the government had taken steps in many industries to concentrate and rationalize production and distribution in accordance with war-time requirements. The President of the Board of Trade, however, emphasized that the re-organization of industry initiated in 1941 was dictated by necessity and not to be regarded as part of a permanent system for the post-war period.[14] However, the government's White Paper on Employment of 1944 was an early indication of impending post-war legislation in the field of monopoly control.

The evolutionary process of the 1965 Monopolies and Mergers Act had found expression in two major legislation: The Monopolies and Restrictive Practices (Inquiry and Control) Act of 1948; and The Restrictive Practices Act of 1956. As stated earlier, prior to 1948, there was no general legislation in Britain concerned with the freedom of companies to create or to abuse positions of market power. It must be noted that the combined incidence of the 1948 and the 1956 legislation

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[13] Ibid., para. 54.

[14] Statement in the House of Commons, 28 March, 1941.

offered considerable protection to the general public against the abuse of market power.[15] Despite the progress made so far by the legislation to prevent the abuse of market power, the merger path to market power remained unimpeded. During the 1950's, despite a rising trend in the volume of mergers affecting British industry, there was little public concern about such activity.[16] It should also be added that the loopholes of the previous legislation created conditions for increased merger activity.

At this stage, it is now appropriate to review the main provisions of both the 1948 and 1956 Acts as a background against which we shall undertake the study of the philosophy of British Merger Legislation of 1965.

The Monopolies and Restrictive Practices (Inquiry and Control) Act 1948

To understand the present merger policy, it is necessary to start with 1948, for in that year the first machinery for the implementation of anti-trust policy in Britain was provided by the Monopolies and Restrictive Practices Act. The Act set up an administrative tribunal - The Monopolies Commission. The Commission has no power to initiate an inquiry. Acting on the recommendation of the Board of Trade (i.e., a government department), the Commission could enquire into single-firm monopolies and in addition was required to prepare a report on restrictive trade practices. Largely as a result of its findings, the Restrictive

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[15] The most comprehensive discussion of the 1956 Act is to be found in R.O. Wilberforce, et al., The Law of Restrictive Trade Practices Court (1966).

[16] On this, see Alex Hunter, Competition and the Law, in Chapters III and X (1966). Also see N.A.H. Stacey, Mergers in Modern Business, particularly Chapter X (1966).

Trade Practices Act was enacted in 1956. The public interest is the keystone of this legislation while the primary purpose of the Act is to impose controls on agreements designed to limit competition.

The Board of Trade (BOT) was responsible for the appointment of commissioners. The Commission's recommendations are not binding upon the government and the legislation, unlike the Canadian legislation, was to operate within the framework of civil and not criminal law. And in Britain, mergers of a certain size are suspect so that the participants have to justify their actions. For a period of eight years the Monopolies Commission was responsible for all investigations into the economic and social effects of private enterprise market power, whether founded upon single firm dominance or upon a network of a trade association or other cartel-like organization.[17]

In presenting the bill to parliament, Mr. Harold Wilson, then president of the Board of Trade, stated the reasons for the government's action. The government, he argued, believed that the nation could no longer afford the restrictive practices which had grown up in industry in the inter-war years. In continuing, he said: "Our industries, instead of taking their merchant adventurer spirit into the market of the world, went in for the apparently easier and safer, but ultimately more disastrous policy of restricting supply, price-fixing, 'feather-bedding' and reliance on a safe protected home market."[18]

The government's case rested on three major factors:

1. The great growth of private monopolies and restrictive practices;

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[17] C.K. Rowley, "Mergers and Public Policy in Great Britain," in Journal of Law and Economic, Vol. 11, April 1968, p. 75.

[18] Part Debates (Hansard) HC, 22 April, 1948.

2. The powers that monopolies or restrictive arrangements may have to inflict damage on the economy of the country or to hold consumers to ransom; and,

3. It was believed that there was the necessity to find out the facts and see whether the powers possessed by monopolies were actually in an anti-social way, and where is found what appropriate actions should be taken to stop these bad practices.

The government believed that combines operate against the public interest when they charge excessive prices to the public, and discriminate against consumers and traders. Monopolies, it is feared, have the power to do harm both in the domestic and world economic relations. They can do this by reducing and limiting the flow of trade and thereby preventing the free movement of goods and services. The government pointed out that a monopoly was neither good nor bad in itself, but the power to be good or bad was there.

The Act made no attempt to define or condemn monopolies or restrictive arrangements. Certain minimum conditions were laid down before any enquiry could be initiated by the Board of Trade. The Monopolies and Restrictive Practices Act 1948 and the Monopolies and Mergers Act 1965 are closely connected since they give the Board of Trade power to refer to the Monopolies Commission for investigation and report the supply of goods or services in the United Kingdom or the export of goods from the United Kingdom if it appears that monopoly conditions as defined in the legislation prevailed.

Monopoly conditions apply with respect to the supply and processing of goods or services where at least one-third of all goods or services supplied or processed in the United Kingdom or in any substantial part of the United Kingdom were supplied or processed by or to any person or two or more persons being inter-connected bodies corporate. The interpretation of the public interest was to be left to the Commission. But nevertheless, the 1948 Act lays it down that in determining whether conditions operate or may operate against the public interest, regard shall be had amongst other things, to the need to achieve certain objectives. These are the production, treatment and home and overseas distribution of goods by the most efficient and economical means; the organization of industry and trade in such a way that their efficiency is progressively increased and new enterprise is encouraged; the fullest use and best distribution of men, materials and industrial capacity, and the development of technical improvements and the expansion of existing markets and the opening of new markets.

The powers of control were negligible for in making its report the Commission only recommended appropriate remedies to the government and the control element had a purely ad hoc application at official discretion. The pragmatic approach of the Monoplies Commission resulted in attention being focussed on securing the technological benefits of large-scale production, while minimizing the danger of exploitation which such advantages might make possible.

The Act of 1948 was passed at a time when the need to increase production, especially that required in heavy industry as well as that for secondary manufacturing constituted the outstanding national priority, and the relevance of this is that, in general, the pre-occupations of the legislators explain the shape of the legislation. If increased production were the aim, then restrictive practices were logically the immediate target. As a result of this pre-occupation, 19 of the 22 reports of the Monopolies Commission were concerned with restrictive practices. There was no effort made to deal with mergers at this time since there appeared to be no a priori reason to believe that a merger will result in an artifical restriction of output so as it is the case with a monopoly or a restrictive agreement.

The ultimate power to act against monopoly or restrictive practices rested with the House of Commons, and in the last resort parliament was to be the final authority on matters reflecting to the public interest. Thus, although it was to be the duty of the Monopolies Commission to report impartially and objectively, and although this impartial opinion would be of great value to the House and the country, such reports were to be in no way binding on the government or parliament.

However, it must be noted that before and during the consideration of the Monopolies Bill in parliament, informed criticisms directed against the new measures appeared in the newspapers and weeklies. The Economist[19] commented this way: "... the powers retained by the Board of Trade are too great for the Commission to be called independent. On the other hand, the Bill suffers from very severe limitations on its scope. Anything to do with wages or labour is specifically and carefully excluded. This is quite indefensible; is there any reason why the facts or restrictive trade union practices should not be ascertained? It would also seem to follow from the wording of the Bill that nationalized industries would be outside its scope, however, much restriction they may practice. Also apparently all service industries are excluded."

The Journal continues further to ask: "Indeed is competition itself in the public interest? The best of bills cannot, in any case, solve the problem of anti-social monopoly over night or next year.

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19 The Economist, April 3, 1948, p. 536.

The experience of the United States, where opinion and law alike have always been solidly opposed to monopoly, is enough to show that when strong incentives to restrictionism exist, there will always be under-the-counter deals, ingenious wrigglings through legal loopholes, and tacit understandings on which noinjured party can lay a finger. For business firms cannot be made efficient any more than men can be made more honest by Act of Parliament alone."[20]

In the New Statesman, one writer expressed doubts about the effectiveness of the new measures: All in all, we shall be surprised if the Bill has large effects; but it is at least a beginning. The main thing will be to get the Commission staffed by persons who want to make the Act work, and not by persons who believe that nine out of ten capitalist restrictive practices are thoroughly justifiable.[21]

In addition to the above reasons given by the government for introducing the Bill, we can find other reasons why such measures were necessary at the time. The Labour Party, the party in power at the time ... calls for public supervision of monopolies and cartels with the aim of advancing industrial efficiency in the services of the nation. Anti-social restrictive practices will be prohibited.[22]

Again during the course of the debate in the House of Commons, a labour backbencher made the following statement: "... it follows, therefore, that if we are to give our people the standard of living they have the right to enjoy, we have to take steps to see that the

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[20] Ibid., p. 573.

[21] The New Statesman and Nation, April 10, 1948, p. 286.

[22] Labour Party Election Manifesto, 1945.

30 per cent (that part of British industry in private hands) are not allowed to use their economic power as ruthlessly in the future as some of it has been used in the past. To me, this is a moral issue. I do not believe that it is right that any one man or group of men should have such economic power that they can, as and when it suits their purpose and profits, impose unemployment upon any section of the community; in other words, they ought not to have the power to say that man shall live or die."[23] It should be pointed out that such views are a manifestation of social democrats on socio-economic matters.

Furthermore, the various reports of the inter-war Commissions would have induced the government to take action against monopolies and restrictive practices. A Committee Report of 1918 had stated: "... it should be a legislative requirement that all international combinations and agreements to which British companies or firms are parties made for the regulation of the prices of the goods or services, or for the delimitation of markets should be registered at the Board of Trade with a statement of the parties thereto and of the general nature and object of the agreement."[24]

Another report in 1919 stated that: "... In every important branch of industry in the United Kingdom (there is) an increasing tendency to the formation of trade associations and combinations having for their purpose the restriction of competition and the control of prices. The report concluded that ... the production of chemicals in this country (U.K.) is almost wholly in the hands of two great consolidations. In soap, tobacco, wallpaper, salt, cement and in the

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[23] Mr. Ferryhough, Parliament Debates (Hansard) HC, 22 April, 1948, Cols. 2075.

[24] Final Report of the Commission on Commercial and Industry Policy After the War (1918), HMSO, CMD 9035, para. 189.

textile trades there are powerful combinations or consolidations of one or other kinds which are in a position effectively to control output and prices."[25]

It was further recommended that it would be desirable to institute in Britain machinery for the investigation of monopolies, trusts and combines. A minority report stated that free competition no longer governed the business world. There is certainly no doubt that some features of the legislation were weak; but one can say that the approach adopted was chosen because there appeared to be no satisfactory alternatives.

Monopolies and Restrictive Practices Commission Bill 1953

This Bill was not a major reform in the system of the law on monopolies. Peter Thorneycroft, the then President of the Board of Trade, introduced the Bill specifically to alter the structure and the constitution of the Monopolies Commission. Otherwise, the Conservative Government was not abandoning the "empirical" and "pragmatic" approach to monopolies which had been laid down in the 1948 Act. Between 1948 and 1953, thirteen specific references and one general reference had been made to the Commission and it had reported only on six.[26]

The unsatisfactory work of the Commission convinced the government of the necessity to overhaul the machinery of the Commission so that more reports should be handled. To this end, the government

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[25] Report of Commission on Trusts (1919) HMSO, CMD 9236.

[26] Annual Report of the Monopolies Commission, 1954.

increased the number of the commissioners up to twenty-five, and a provision was made for members to work in groups of five. Many members supported this change as they, in the past, were dissatisfied about the slow progress of the former Commission.

The principal aim of this Bill, then, was to increase the size of the Monopolies Commission from ten to twenty-five members and to empower it to work in groups of five. The aim being to make it possible for most industries to be investigated concurrently. In conclusion, we can say, therefore, that the 1953 Act was an improvement in the machinery for dealing with monopolies.

The Restrictive Trade Practices Act 1956

As it was pointed out earlier, the general report on collective discrimination made by the Monopolies Commission provided the essentials of the new enactment of 1956. The government itself was against employing the stigma of the "criminal law" while it could not ignore the criticism that re-examination of the practices case-by-case would be a slow and cumbersome affair and repeat to a large extent work already done by the Monopolies Commission. Nor could it neglect the fact that the judicial tradition of independence, objectivity, and the publicity of the law courts would carry more weight in the world of business than would an administrative tribunal.

The Restrictive Trade Practices Act of 1956 introduced for the first time a strong ruling in favour of competition and set up the machinery for registration of restrictive agreements such as price-fixing and quota systems, as the first stage of procedure. In the second stage, all agreements are challenged by an independent government agent - the Registrar of Restrictive Trade Practices - before a "superior court of record" - the Restrictive Practices Court. The court is unusual in that it has lay members as well as legally qualified judges. Lay members are judged to be qualified by virtue of their knowledge of or experience in industry, commerce or public affairs. Once a restriction is before the court, it is to be deemed against the public interest unless the court is: (1) satisfied that at least one of the seven specified circumstances exist; and (2) is further satisfied that the restriction is not unreasonable having regard to the balance between those circumstances and any detriment, actual or likely to the public, or to certain persons not party to the agreement.

The registration provisions of the Act are made applicable to any agreement between two or more persons carrying on business within the United Kingdom in the production or supply of goods or in the application of goods to any process of manufacture in which certain restrictions are accepted. The restrictions are in respect of the following five matters:

1. The prices to be charged, quoted, or paid for goods supplied offered or acquired, or for the application of any process of manufacture to goods;

2. The terms of conditions on or subject to which goods are to be supplied or acquired or any such process is to be applied to goods;

3. The quantities or descriptions of goods to be produced, supplied or acquired;

4. The processes of manufacture to be applied to any goods, or the quantities or descriptions of goods to which any such process is to be applied; or

5. The persons or classes of persons to, for or from whom, or the areas or places in or from which goods are to be supplied or acquired, or any such process applied.

To succeed before the courts, it was necessary to negotiate an agreement successfully, through one of seven carefully defined public interest "gate-ways" and to satisfy the court in addition that any benefit from the agreement was not outweighed by corresponding detriments.[27] The public interest "gate-ways" are the following:

1. Where it can be shown that safety is involved;
2. Where it is shown that the removal of the arrangement would deny a specific and substantial benefit to consumers;
3. Where it is necessary for protection against a competing ring;
4. Where it is found to be necessary for dealing with a monopoly buyer or a monopoly seller;
5. Where the industry is being deliberately contracted with the approval and whole hearted support of the government of the day;
6. Where serious and persistent unemployment would follow "in an area" or harm the export trade of the nation; and,
7. In other matters which appear reasonable to the courts.

The Monopolies Commission in a reduced form continued to retain jurisdiction over agreements concerning export markets and over the affairs of the dominant firm.

To what extent has the Act defined public interest and laid down rules as to how it should be considered in relation to registered agreements? In the first place the Act declares that a restriction shall be deemed to be contrary to the public interest unless the court is satisfied in two respects. This places the burden of proof on the

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[27] Rowley, op. cit., p. 76.

parties concerned and if they wish to continue their agreement, they must rebut the presumption.

Secondly, the statute sets out seven specific circumstances and the onus is on the parties to the agreement to show that one of these exists in order to pass the first test of satisfaction. These represent "only a short list of specific matters on which the court is asked to find" but it can be argued that the circumstances referred to in paragraphs (a)-(f) are situations in which the public has a definite interest. Paragraphs (a) and (b) expressly deal with the protection of the public interest against injury and loss of specific and substantial benefits or advantages. As the Act is meant to stimulate competition, it can be argued that it is not in the public interest to have businesses in a position where it is difficult or impossible for them to compete over the long-run, owing to the market being substantially controlled by one firm or group of firms.

Although the Act failed to define the "public interest" yet parliament has at least directed the adjudication of the court in certain situations where society has a stake. The economic policy of the law makers has been set out in the statute. Restrictive agreements are not in the public interest, although there may be exceptional cases.[28]

While the statute has thus made the court apply itself to the issue of public interest and has to some extent created categories of this interest, there are still considerable areas in which public interest has been left undefined. What is meant by "protect the public against injury" in paragraph (a)? What are the "specific and substantial

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[28] Richard Gosse, "The Enforcement of Competition in the United Kingdom," in Canadian Bar Review, Vol. 38, 1960, p. 191.

benefits and advantages" to the public in (b)? And what amounts to "detriment to the public" in the second test of satisfaction?"[29] This implies that parliament has led the court to its own devices to determine the meaning of these expressions.

However, despite the shortcomings of the Act, the essence of the legislation is to provide a framework within which industry can operate more effectively in the national interest. And if those responsible for adjudicating lose touch with that interest and take too narrow a view of their function, then instead of encouraging productivity, decisions may actually prove obstacles. However, a large number of restrictive agreements have been brought to an end; and competition has thus been stimulated to some extent with presumably some increase in productivity.[30]

However, despite the progress made so far in Britain's anti-trust legislation, to give protection to the general public against the abuse of market power, a number of loopholes remained, it is true, but with a relatively simple extension of the existing legislation (1948 and 1956 Acts), they could be eliminated. For instance, service trades were excluded from the scope, both of the 1948 and 1956 legislation. The merger path to market power remained unimpeded.

In the 50's, despite a rising trend in the volume of mergers affecting British industry, there was little public concern about such activity. From 1960 onwards, however, public awareness of the merger

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29 Ibid.

30 For a detailed discussion see Gosse, Ibid.

problem as viewed from an anti-trust standpoint gathered momentum.[31] In this wake, members of all political parties sensed the change in public opinion and responded during the 1964 General Election Campaign with promises of merger legislation. Thus in 1965, the newly-elected Labour Government honoured its political pledge on the merger issue.

The Monopolies and Mergers Act 1965

The Monopolies and Mergers Act of 1965 created the machinery for the regulation of mergers in Britain. The Bill was considered as a part of a comprehensive program for streamlining and modernizing British industry. Mergers were not considered bad in themselves, and in some cases it was argued that greater size and further amalgamations may be desirable in the public interest. However, it was also argued that undesirable mergers should be disallowed; and mergers affected were those that were likely to create or to expand market power.

The system of intervention was essentially administrative, and the judicial machinery approved since 1956 for the control of restrictive practices was by-passed. The Board of Trade was to be responsible for the selection of merger references. The Monopolies Commission was to direct inquiries and to report in an advisory capacity to the government; but the government was under no obligation to execute policy recommendation by the Board of Trade.

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[31] Public interest in mergers was reflected in publications of research groups within both the Conservative and Labour parties viz.: The Bow Group, Monopolies and Mergers (1963); The Conservative Political Centre, publication No. 273; Monopoly and the Public Interest (1963; and Trades Union Congress, Monopolies and Mergers (1964).

By this Act mergers were no longer to be examined after their occurrence. Rather, it was proposed that certain mergers were to be held up until the Monopolies Commission conducted appropriate investigations. The President of the Board of Trade clarified the intention of the government in these words: "We are of course not proposing for one moment to ban or even delay all mergers, but merely to have the power to subject them to the test of public interest; and to delay where necessary; and prohibit them where the Board of Trade and this house are convinced that they would be against the public interest."[32]

The minimum requirements to be met before a merger could be referred for investigation were clearly established: Mergers which result in or intensify a monopoly situation as defined in the 1948 Act (i.e., where one-third of supply of goods and services is in the hands of one firm). "... either (1) as a result the following conditions prevail or do so to a greater extent, as respects the supply of goods or services of any description, at least one-third of the goods of that description which are supplied in the United Kingdom or any substantial part thereof are supplied by or to any one person, or by or to the persons by whom the enterprises (so far as they continue to be carried on) are carried on, or as respects the supply of services of that description in the United Kingdom or any substantial part thereof is, to the extent of at least one-third by or for any one person, or by or for the persons by whom the enterprises (so far as they continue to be carried on) are carried on; or (2) the value of assets taken over

[32] Douglas Jay, Parliamentary Debates.

exceeds five million pounds."[33]

The Monopolies Commission upon the receipt of a merger reference was first to report whether the merger satisfied the criteria set down in section 6(1)(b) and if so to investigate and to make a report whether the merger operated or might be operated against the public interest. If the Monopolies Commission reports against a merger, the Board of Trade may take action to remedy the situation by dissolving a business, sale of part of its assets or in case of a prospective merger, forbidding it to take place. A maximum period of six months was the prescribed time limit within which each merger report was to be completed. The rationale for the time limit was that it allowed the government to refer to merger proposals before they were acted upon; if necessary, a "standstill" order to prevent the premature completion of a merger.

Up to the middle of 1969, the Board of Trade had assessed the likely effects of 430 actual or prospective mergers. Of these "examined mergers" about 60 per cent were believed to satisfy the size criterion, 25 per cent the monopoly criterion and the remainder satisfied both. About 85 per cent were predominantly horizontal mergers.

Among the "examined mergers," only 12 were referred to the Monopolies Commission including two newspaper mergers. The referred mergers were referred in terms of the size criterion. Of the number, three were found to be against the public interest - Ross and Associated Fisheries; Burton and United Drapery stores; and Rank De La Rue.

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33 The Monopolies and Mergers Act, 1965.

It is apparently clear that the British approach to controlling mergers is different from Canada by making explicit the criteria by which mergers are to be brought under the surveillance. However, it is still questionable whether the size criterion is particularly relevant to the damage to be apprehended from mergers. On the other hand, the Board of Trade has complete discretion in the crucial matter of deciding what constitutes a category of goods, or services. The Board may define supply to include or exclude different forms of supply or to restrict the reference to supply in any substantial part of the United Kingdom market.

The reference criteria can therefore be interpreted to permit reference of practically every merger and are not particularly relevant to risk of detriment arising from the abuse of market power.[34] This practice is somewhat similar to that in Canada where the Director of Investigation has complete discretion in making his preliminary investigation. The Board of Trade (and the Director of Canada) exercise a decisive role in that they decide which mergers need closer scrutiny and to that extent are prima facie against the public interest.

With the inclusion of mergers in the anti-trust laws of Britain, by the 1965 Act, it led to a corresponding need for new statutory powers to enforce contrary decisions of the Monopolies Commission. The appropriate powers were provided by section 3 of the 1965 Act:

> (5) The Board may prohibit or restrict the acquisition by any person of the whole or part of the undertaking or assets of anothr person's trade or business, or the doing of anything which will or may result in any bodies corporate becoming interconnected bodies corporate, or may require that if such an acquisition is made or anything is done which has that

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[34] Beachman and Jones, op. cit., p. 111.

result, the persons concerned or any of them shall thereafter observe any prohibitions or restrictions imposed by or under the order.

(6) The Board may provide for the division of any trade or business by the sale of any part of the undertaking or assets or otherwise (for which purpose all the activities carried on by way of trade or business by any one person or by any two or more interconnected bodies corporate may be treated as a single trade or business) or for the division of any group of interconnected bodies corporate and for all such matters as may be necessary to effect or take account of the division.[35]

Thus the 1965 Act established the framework for the public supervision of mergers.

Public Interest Issues

Various reports submitted by the Monopolies Commission provide evidence that the government has maintained conscientiously the pragmatic approach to mergers enshrined in the 1965 Act. References have been reserved for mergers and merger proposals in which subsequent public detriment appeared to be a significant possibility. The Commission also has demonstrated its willingness to inquire into merger references without openly committing itself to a specific philosophy on what constitutes the "public interest." Each merger investigation uses a different yardstick to measure the benefits alleged to flow from the mergers under investigation. Here lies a significant difference in approach from the Canadian legislation where the courts must be satisfied that detriment to the public can occur only when competition is substantially reduced and/or a specific detriment is established.[36]

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[35] The Monopolies and Mergers Act, 1965.

[36] See reports on Beer and Sugar in the previous chapter.

Although the anti-Merger Act of 1965 was designed to regulate the merger path to market power and to protect the public interest, yet the Act failed to estalbish precise public interest "guidelines" for merger inquiries and the responsibility for so doing rested with the Monopolies Commission. What the Act did as we have seen was to lay down the criteria for investigating mergers and/or proposed mergers (the minimum market share criterion and the value of assets criterion). The Act did not specify that benefits should be determined by reference to economic criteria, and so if it sees fit the Monopolies Commission can refer to political, sociological and even philosophical criteria to judge the public interest.[37] With no guidelines on which to reach conclusions in their investigations of mergers, members of the Monopolies Commission reach their own conclusions by reference to the assumptions, principles or prejudices which their training and experience caused them to apply to economic affairs.[38] A brief review of two of the Commission's reports on mergers will illustrate these general conclusions, but first we shall establish the "public interest" criteria in previous legislation (1948, 1956 Acts); for the Monopolies Commission had paved the way between 1948 and 1955 for the public interest "gate-ways" which were laid down in the 1956 Restrictive Trade Practices Act. Moreover, from the Commission's dominant firm reports after 1956, public interest criteria emerged which might be relied upon by companies anxious to comply with the current philosophy

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37 Rowley, op. cit., p. 108.

38 G.C. Allen, Monopoly and Restrictive Practices (London: George Allen & Unwin, 1968), p. 66.

of anti-trust in Britain.[39] Thus, it was reasonable to presume that the Commission might conduct a similar exercise in the field of mergers. As pointed out from the beginning of this chapter, the Monopolies Commission is an administrative tribunal whose functions are to discover the likely economic effects of mergers and in the light of the evidence until the government accepts the recommendation no action is taken. On the contrary in Canada we have seen that since the crime is a criminal offence, it is the courts which in the last resort determine what constitutes a public detriment in merger cases.

Before the 1965 Act, Britain had enacted two major acts with specific provisions on safeguarding the "public interest." These legislations - the 1948 Act and 1956 Act and subsequent Acts - were a part of a wider policy goal of the government to stimulate the economy, promote full employment, rationalize industry and to maintain a healthy international trade balance through the promotion of export markets and so on. It was argued that unless British industry could raise its efficiency and expand its sales to foreign markets, there could be little hope of social progress. The 1948 Act - the anti-Monopoly Act - entrusted the Monopolies and Restrictive Trade Practices Commission to investigate whether monopoly conditions exist, and if so, whether they (conditions) operated or could operate against the public interest. The Act established a vague criteria of the public interest designed to allow the Commission to formulate its own philosophy. Section 14 of the Act established the following "guidelines" for

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39 This became especially apparent during the early 1960's with the publication of a number of important reports.

the Commission:[40]

> All matters which appear in the particular circumstances to be relevant shall be had to the need, consistently with the general economic position of the United Kingdom to achieve:
>
> (a) the production, treatment and distribution by the most efficient and economical means of goods of such types and qualities, in such volume and at such prices as will best meet the requirements of home and overseas markets;
>
> (b) the organization of industry and trade in such a way that their efficiency is progressively increased and new enterprise is encouraged;
>
> (c) the fullest use and best distribution of men, materials and industrial capacity in the United Kingdom; and,
>
> (d) the development of technical improvements and the expansion of existing markets and the opening up of new markets.

This section of the Act has been criticized by many economists on the grounds that the statements are pregnant with problems of definition; which were scarecly expected to be of practical use to the Monopolies Commission. However, against this criticism, we should bear in mind that the Act was drafted against a background of uncertainty concerning the effects of monopoly and restrictive practices; and in such circumstances it would have been unrealistic to define narrowly the limits within which the new body should direct its approach. However, one writer[41] believes that the only specific guidance from section 14 is the emphasis upon a nationalistic approach.

As pointed out earlier, certain basic weaknesses of the 1948 legislation and the hostility of industrialists ushered another stage in the evolution of monopoly policy vis à vis the public interest.

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[40] Section 14 of the 1948 Act.

[41] C.K. Rowley, The British Monopolies Commission (London: George Allen & Unwin Ltd., 1966), p. 72.

The new law, the Restrictive Trade Practices Act of 1956, brought a striking change in policy as well as procedure. The law had now ceased to be neutral in respect of certain restrictive practices and had become definitely hostile. As from now, it is presumed that those practices - price agreements, exclusive dealing arrangements, etc. - were against the public interest and therefore had to be registered at the Restrictive Trade Practices Court. Section 21 of the Act which deals with the provision of the seven gate-ways is designed to put the onus of proof on the parties concerned that their restrictive practices are not against the public interest. Therefore, it will be observed that the circumstances which might be held to justify the retention of restrictive practices varied widely. Thus, an agreement might continue if its removal would cause consumers to lose a specific and substantial benefit, or if it protected the public against injury or if it was required to enable the producers to deal with a monopoly buyer or customer ....[42] And finally, the court must be satisfied that the advantages of allowing the agreement to continue by reason of one or more of the "gate-ways" were not balanced by any detriment to the public interest. On the whole, this section of the anti-combines legislation in Britain has been more successful.[43]

The Monopolies Commission has viewed extension of market power as a detriment when deciding whether a referred merger is likely to operate against the public interest. The Commission has weighed against any detriment of this kind such net benefits as the merger might be

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[42] Allen, op. cit., p. 92.

[43] Ibid.

expected to provide. Unlike the Canadian legislation, the 1965 Act did not limit the Commission's freedom to determine what should or should not constitute a benefit to the public. This suggests that benefits considered by the Commission vary from investigation to investigation as illustrated in our two case studies. The tasks of determining what constitutes a benefit have not been easy and on this the Commission had met strong criticisms from many economists.[44] In concluding, it becomes clear to discover that the British concept of the public interest is couched within a broader concept. We shall now proceed to examine the Commission's divergent philosophy in the field of mergers. From the plethora of mergers which have happened since the 1965 Act came into operation, the Monopolies Commission has been asked to pronounce on only a handful of them (eleven up to 1971). With regards to their merger investigations, two main questions are generally asked: Whether the Monopolies Commission applies the same general criteria in their investigations and whether the Monopolies Commission acts consistently between one merger and another.

To provide answers to the above questions, two of the reports are reviewed in detail, since both were referred under the value of assets and monopoly criteria; but first it is appropriate to summarize the conclusions of other merger reports by the Monopolies Commission.

To start with it must be borne in mind that for any merger policy one cannot expect to have a consistent government policy as there exists in the country the very real difference in opinion between those who see that size brings increased efficiency and those who see the opposite.

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[44] Rowley, op. cit., p. 108.

In addition, we have stated earlier that one of the objectives of the British Merger Policy is to increase industrial efficiency and international competitiveness, and that the approach is empirical and pragmatic, which recognizes the diversity of industrial situations. The basic assumption, therefore, is that there is no right structure which would be equally applicable to all industries.

The foregoing observation and the different reports of the Monopolies Commission would suggest that the Monopolies Commission might not have applied the same general criteria in their investigations, or that they have been consistent between one merger and another. This is also borne out by the power given to the Monopolies Commission to decide what emphasis to put on structure, behavior and performance as they have been and as they might be.

Merger Reports by the Monopolies Commission

Since the inception of the 1965 Act, over six hundred mergers fell within the scope of the mergers legislation and were examined by the Board of Trade (now the Department of Trade) for potential detriment to the public interest. The following is a summary of the Monopolies Commission's findings in each of the referred cases. 7

In the proposed United Drapery Stores and Montague Burton Merger, the merger affected the retail market for men's outwear. Burton's case for the merger rested on the grounds of shortages of top management and of the need to improve performance in mail order and in the Peter Robinson Women's fashion chain. This proposed merger was opposed on the grounds that it would hold about 35 per cent of the total market for men's suits, with a higher proportion of sales in the cheaper end of the market. The Commission's view was that a firm of Burton's size ought to be able to import top management.

Under section 6 of the 1965 Act, the proposed bid and counter-bid by the Beechman Group and the Boots Company for Glaxo Group were referred to the Monopolies Commission. A period of five months of investigation led the Monopolies Commission to the conclusion that either proposed merger could be expected to operate against the public interest. The Commission's findings were that each company was large enough on its own to support research and development, and that the loss of an independent control for decision taking about the future direction of research and development outweighed the other benefits which might accrue from the merger.

The Monopolies Commission approved the acquisition by Berrow's Organization (subsidiary of News International Ltd.) of the Country Express Group. This acquisition of the four local weekly newspapers in the County Express Group increased Berrow's ownership of weekly newspapers in the Worcestershire area. Nevertheless, the Commission did not expect the merger to operate against the public interest.

In the British Insulated Callender's Cables Ltd. (one of the largest and the leading organization of its kind in the world with complete facilities for research, manufacture and contracting in transmission and distribution of electrical energy for power and communication purposes) and Protenax Merger, the Monopolies Commission gave its approval. Protenax is a producer of mineral insulated cable, and prior to the merger, these two companies were the sole substantial producers of mineral insulated cables in Britain. As a result of this merger, British Insulated Callender's Cables Ltd. now supplies over 90 per cent of mineral insulated cables in the United Kingdom. The Monopolies Commission's reasons for approval of the mergers rests on arguments of cost savings and the possibility for more rapid increase in exports, which the Monopolies Commission concludes 'may turn out to be the most valuable result of the merger for the public interest.'

In the merger between Barclays, Lloyds and Martins banks, the Monopolies Commission opposed it, arguing that there was little prospect of more than marginal benefit to the public interest; that competition between banks is in the public interest and that such competition as there is between the clearing banks is likely to be greater with four large banks of roughly comparable size than with three large banks, with one as large as the other two combined. Further, the Commission continued that it would be in the public interest of medium-sized and small businesses that there should be more, rather fewer suppliers of finance.

Similarly, the Commission rejected the Rank bid for De La Rue in 1969 as it believed that the merger would reduce efficiency in the latter mainly through its effects on key personnel in the company who would either leave or suffer loss of morale. During the same period, the Monopolies Commission had given its approval to the following additional mergers: The Thorn Electrical/Radio Rentals Merger, the merger between Unilever and Allied Breweries, the Grand Metropolitan Hotels/Watney Mann, and the Imperial Tobacco/Courage Mergers and the Consolidated Gold Field/Amey and Red Land Purple. In each of these mergers, the Monopolies Commission concluded that none of them resulted in significant reduction of direct competition. With this summary and conclusions of Monopolies Commission reports on mergers, we shall now proceed to undertake a detailed review of two additional cases.

The British Motor Corporation and the Pressed Steel Company

This was the first merger case to be referred to the Monopolies Commission under the 1965 legislation. The merger was referred under the "value of assets" criterion. The government regarded the affected market - motor vehicle supply - to be of "special" economic importance. In the words of the government: The industry occupies a key position in the national economy. It makes an important contribution to the nation's wealth but is dependent for its own well-being on the general state of the economy.[45]

In Britain and in other countries, the automobile market is oligopolistic. Since the end of the Second World War, there had been a continuous decline in the number of automobile manufacturers. The industry is characterized by large producers which account for an increasingly predominant share of total output. The number of car producers dropped from 89 in 1920 to 32 in 1946, and to 20 in 1964, out of which 13 accounted for less than one per cent of market share. The Monopolies Commission endorsed the concentration of the automobile market, but came to the conclusion that competition was healthy among the producers. At the time of the inquiry:

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[45] Douglas Jay, op. cit.

> With the growth in public demand for vehicles there have emerged a few concerns which are able to take advantage of the considerable economies of large-scale production in the industry and which possess sufficient capital for the mass production of a high value product such as a motor vehicle. Against a background of market expansion and rapid technological development there has been a great increase in productive capacity and the surviving manufacturers operate under conditions of vigorous competition. This usually takes the form not so much of price competition as of attempting to produce models which possess some special features and which give better value than those produced by competitors. [46]

In the British Automobile Industry about 96 per cent of car production by units and some 85 per cent of commercial vehicles production by units had been accounted for by the "big five": The British Motor Corporation; Ford; Vauxhall; Rootes; and Standard-Triumph International. The following table shows the respective market shares (in terms of production) of the "Big Five" and of the British Motor Corporation in 1963 and 1964.

According to the table, British Motor Corporation was the largest single producer of motor vehicles accounting for nearly 36 per cent of total British production (measured in units). In 1964 British Motor Corporation exported about 40 per cent of its production. Between 1952 and 1964 British Motor Corporation's net assets in the United Kingdom increased from 34 million pounds to 88 million pounds, while its overseas assets rose from 10 million pounds to 30 million pounds. In addition to vehicle production, British Motor Corporation extended backwards into many aspects of component production.

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[46] Ibid.

TABLE 9

CAR AND COMMERCIAL PRODUCTION IN
BRITAIN IN 1963 AND 1964 (UNITS)

1963

Manufacturer	Cars	Com. Vehicle	Total
"Big Five"	1,564,762	340,645	1,905,407
% of Total	97.32	84.36	94.71
Of Which BMC	618,551	141,514	760,065
% of Total	38.47	35.04	37.78
Others	43,177	63,136	106,313
% of Total	2.68	15.64	5.29
Total	1,607,939	403,718	2,011,720

1964

Manufacturer	Cars	Com. Vehicle	Total
"Big Five"	1,798,568	384,364	2,182,932
% of Total	96.30	82.70	93.60
Of Which BMC	682,673	152,620	834,933
% of Total	36.55	32.76	35.80
Others	69,072	80,372	149,444
% of Total	3.70	17.30	6.40
Total	1,867,640	464,736	2,332,376

Source: Monopolies Commission, The British Motor Corporation Ltd. and The Pressed Steel Company Ltd., Report on the Merger, 1966.

At this time Pressed Steel constituted the largest independent motor car body and body tool manufacturer virtually in the whole world. In 1964 its stock of capital employed was valued at 45 million pounds. Pressed Steel supplied car bodies for about 40 per cent of all passenger cars produced in the United Kingdom.

Prior to the merger, British Motor Corporation obtained its car bodies from outside sources and its subsidiaries. Both British Motor Corporation and Rootes Group were the two most important customers of Pressed Steel. In regard to its motor industry business Pressed Steel is dependent for approximately 80 per cent by value on British Motor Corporation and Rootes whose purchases are approximately equal .... British Motor Corporation's purchases of car bodies represent roughly a third of its requirements, while Rootes, Rover and Jaquar are almost entirely dependent on Pressed Steel for their car bodies.[47]

Thus the merger between British Motor Corporation and Pressed Steel brought to an end the existence of the only major independent car body builder in the United Kingdom. Other producers, of motor vehicles, now found themselves dependent as a result of the merger for their supplies on an organization controlled by British Motor Corporation. The attention of the Monopolies Commission was focussed on:

> The taking over the Pressed Steel by British Motor Corporation was bound to raise the question of continuity of supply, upon equitable terms, to these manufacturers, each of which has its own contribution to make to our overall range of production and to our export comings. There was an obvious danger that British Motor Corporation might be tempted, now or in the future to place its own needs above those of other companies which were, of course, to a greater or lesser degree, its competitors.[48]

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[47] Monopolies Commission Report.

[48] Ibid.

The merger undoubtedly left little chances for the remaining independent body suppliers to expand rapidly and fill the gap left vacant by Pressed Steel. However, the Commission was of the opinion that the possibility of backwards expansion by vehicle manufacturers to produce vehicle body was a factor which influenced Pressed Steel in undertaking the deal.

> ... Although prior to the merger Pressed Steel was carrying on a successful business its future as an independent concern was at least precarious. Eighty per cent of its output of bodies was absorbed by two powerful companies, either or both of which might ultimately undertake the manufacture of its own bodies. If one of them should do so, Pressed Steel would suffer a severe setback, if both, the effect would almost be fatal. 49

Furthermore, the Commission argued that there was a universal trend towards backward expansion into body production by principal motor vehicle producers in both Europe and in the United States. Before the merger, only British Motor Corporation and Rootes among the "big five" were dependent to some extent upon external suppliers. However, despite the fact that this merger posed a danger to competition, should the new organization abuse its power, the Commission ruled in favour of the merger, on assurances obtained from British Motor Corporation.

> ... We have ... been assured that if necessary, Pressed Steel will expand its capacity to meet increased demand, as it has done in the past. In the event of a shortage of materials, such as steel, allocations will be made to all customers on a provide basis in accordance with the practice followed on previous occasions ... Accordingly while in common with others we may regret the loss of Pressed Steel's independence, in all the circumstances we conclude that the merger does not operate and may not be expected to operate against the public interest. 50

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[49] Ibid.

[50] Ibid.

Ross Group and Associated Fisheries

The proposed merger between Ross Group and Associated Fisheries was referred to the Commission under the monopoly criterion. The Board of Trade was concerned with the merger's possible impact, both upon competition within the deep-sea fishing fleet and upon competition inside the distributive network handling the deep-sea catch.[51]

By then the British fishing fleet consisted of about 2000 vessels. Among this there were 617 deep-sea trawlers of at least 80 feet long. The remainder were smaller vessels which fish mainly in shallow waters. The deep-sea vessels are divided into three sections:

(1) The smallest vessels (80-110 feet in length) form the "near-water" group. This group operates in the North Sea, Irish Sea, and the waters off Western Scotland, and Ireland and South West of the British Isles.

(2) The "middle water" vessels (110-140 feet). These fish in farther waters within distance covered by latitudes 43N and 63N and as far as longitude 17° west.

(3) Areas not covered by the above limits are the "distant waters" and only largest vessels of over 140 feet in length fish in them.

Table 10 shows that deep-sea fleet is concentrated only in few British ports: 90 per cent of the deep-sea fleet is concentrated in five ports - Lowestoft (46%) and Aberdeen (22%) are the main ports in the "near water" section; Aberdeen (32%), Grimsby (32%) and Fleetwood (21%) dominate within the "middle water" section; Hull (59%) and Grimsby (32%) constitute the only important ports for the "distant water" section.

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[51] The parties voluntarily delayed the merger during the period of investigation.

TABLE 10

THE PORT CONCENTRATION OF THE DEEP-SEA FLEET
IN DECEMBER, 1965

Port	Number of Vessels (length in feet)			
	80-109.9	110-139.9	140+	Total
Hull	-	1	116	117
Grimsby & Immingham	22	61	63	146
Fleetwood	8	40	13	61
Lowestoft	106	10	1	117
Aberdeen	50	62	2	114
Total: Five Ports	186	174	195	555
Other Ports	43	18	1	62
	229	192	196	617

Source: Monopolies Commission, Ross Group Ltd., and Associated Fisheries Ltd., A Report on the Proposed Merger, 1966.

Although port concentration of deep-sea fleet is high, yet ownership concentration is less noticeable. Ross Group accounts for 10.5 per cent and Associated Fisheries 14 per cent are the two most important owners of deep-sea vessels. In Table 11, we can see that concentration of ownership is more marked in the "distant water" section where Ross and Associated Fisheries own respectively 18 and 42 per cent of total vessels.

In the deep-sea industry the two most important issues on market power are the percentage of vessel ownership and the proportion of fish landed by each vessel owner. In this proposed merger, the Monopolies Commission viewed with concern the variety of fish landed, and more importantly the share of landings of specific fish categories by each company or companies.

TABLE 11

DEEP-SEA FLEET, FEBRUARY, 1966

	Number of Vessels			
	(1) Ross	(2) Ass. Fisheries	(1+2)	Total All Owners
Distant Water	35	82	117	196
Middle Water	17	6	23	192
Near	13	-	13	229
Total	65	88	153	617

Source: Monopolies Commission, Ross Group Ltd., and Associated Fisheries Ltd., A Report on the Proposed Merger, 1966.

The total fish catch in 1964 in the United Kingdom was approximately 845,000 tons, valued at 57.2 million pounds. The greater part of it was of the demersal varieties (cod, haddock, plaice, skate, rays, whiting, Lake Saithe lemon sole) and the remaining balance consisted of pelagic fish (herring, mackerel, whitebait, sprats) and shell fish.

TABLE 12

THE UNITED KINGDOM CATCH IN 1964

	Weight Thousand Tons	Per Cent of Total	£ M.	Value Per Cent of Total
Total Catch	845	100	57.2	100
Of Which Demersal	680	80	51.1	89
Herring	98	12	2.7	5
Other Pelagic	39	5	0.5	1
Shell Fish	28	5	2.9	5

Source: Monopolies Commission, Ross Group Ltd., and Associated Fisheries Ltd., A Report on the Proposed Merger, 1966.

Over two-thirds of the pelagic fish and all of the shell fish are caught by the inshore section of the fishing fleet, and approximately 80 per cent of demersal fish is caught by the deep-sea fleet. The enlarged Ross Group/Associated Fisheries fleets in 1964 landed 26 per cent by weight of the total of demersal fish and pelagic fish other than herring from British vessels. The third largest fleet in the United Kingdom accounted for 6.5 per cent. The combined Ross Group/ Associated Fisheries fleets accounted for a comparatively small landings of whitefish (herring), thus failing to meet the one-third of the market condition laid in 1948 (i.e., the minimum condition for anti-trust intervention).

However, in establishing its case, the Monopolies Commission argued that the combined Ross Group/Associated Fisheries accounted for a higher proportion (48 per cent by weight) of the total landings of whitefish at the Humber ports of Hull, Grimsby and Fleetwood; while the second largest fleet accounted for only 6 per cent landings in those ports. In its analysis, the Commission further placed cod landings separately from the demersal varieties. In 1964 cod landings in Britain accounted for about 41 per cent (by weight) and 45 per cent (by value) of all whitefish landings excluding shell fish. Landings of cod fish at the Humber ports accounted for 72 per cent of total cod landings by British vessels. Ross Group/Associated Fisheries were responsible for 54 per cent of total British landings of cod at the Humber ports and 39 per cent of total British landings of cod at all ports in 1964.

In order to make the market power issue look high in this merger, the Commission proposed to establish separate markets for different varieties of fish. They admitted that the proposed merger would not appreciably affect its market power if all fish varieties can be treated as close substitutes:

> Their fleet could be expected on the basis of recent levels of fish supplies to provide less than one-fifth of the total supply of fish in the United Kingdom market (excluding canned fish). If the market for fish could properly be regarded as a single whole, in which all fish was freely and fully in competition regardless of variety, quality or source, such share would not appear sufficient to enable the combined company to exercise undue influence on the market, even though it would be substantially larger than any other single share. [52]

Thus the Commission declared that the market for fish belonged to distinct sections and that the one for "distant water," cod in particular, was clearly distinct from other fish markets:

> We are satisfied, that although the market in one port is sensitive to supplies coming into other ports, the market as a whole does fall into distinct sections by reference to types of fish and class of customer and while there is some interchange and price influence among them, there is not full and free competition .... We consider that the bulk of distant water cod fish serves a market which can be clearly distinguished from that served by, for example, high quality flat fish landed from inshore vessels and similar fish imported as quick frozen fillets. [53]

Furthermore, the Commission insisted that cod landed at the Humber ports was of more strategic importance than cod landed somewhere in terms of market power. The Commission pointed out that: "Of the total supply of cod over 70 per cent is landed at the two Humber ports, and we accepted the view expressed to us by many of those participating in the trade that anyone who was in the position to control the supply

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[52] Monopolies Commission Report.

[53] Ibid.

to Humber cod would be able to influence the market price of cod generally."[54] Therefore, the Commission concluded that the enlarged Ross Group/Associated Fisheries would exercise considerable market power for cod. In the words of the Commission:

> They would immediately following the merger be a great deal larger than any other company operating in this field. More than half the supplies would be under their control and if they chose they would be able to take advantage of their dominant position ....[55]

Again since the Ross Group/Associated Fisheries operated their own distribution network, the Commission further considered the impact of the merger upon market power in distributing fish. The effect of the merger upon the port auction system of distributing fish was specifically taken into consideration:

> Ross Group assured us that they have no intention of dispensing with sales by auction for their landings of wet fish and they explained that their recent experience of withdrawing certain species from the auction had not been a success. But the possibility would remain that they could dispose of the whole, or a large part of their landings through their own distribution network without giving other buyers a chance to bid for it. Circumstances could arise in which they would regard it as desirable to do so in which event they would be in a position to name their own price to retailers without the check of effective competition from other merchants.[56]

Thus in its closing remarks, the Commission believed that the significant feature of the merger with regards to market power was the blending of the large distribution organization with a predominant and growing share of the supply of cod at Humber ports: "We accordingly conclude that the merger would give the combined company great power

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[54] Ibid.

[55] Ibid.

[56] Ibid.

over the market and that this power would grow."[57]

We have already pointed out that the 1965 merger legislation was designed to regulate the merger path to market power. It was not the intention of government to discourage, through delays and denials, desirable mergers. Despite the Commission's pragmatic approach in merger cases, yet pragmation is not enough to ensure that the public interest is not affected adversely by the extension of anti-trust to the field of mergers. Much is dependent upon the competence of the Commission in the conduct of its enquiries.

As we have pointed out from the beginning, the British legislation to controlling mergers was not spontaneous. It was preceded by a series of legislation dating from the 1948 legislation on Monopolies. Modern legislation thus started with the Monopolies and Restrictive (Inquiry and Control) Act of 1948.

Looking at the new legislation of 1965, to combat mergers, the fundamental conclusion that can be drawn is that the British Policy-Makers are determined to approach the problem in a cautious manner. This "pragmatic" way of controlling mergers can best be illustrated by the case-to-case approach. This is borne out by the observation that precise benefits considered by the Commission have varied from investigation to investigation. These benefits are classified under the broad headings: technical and technological; financial; managerial; and marketing functions of business firms.

Furthermore, unlike the Canadian legislation, the British legislation of 1965 did not limit the freedom of the Commission to

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[57] Ibid.

determine what should or should not constitute a benefit. The Act did not state that benefits should be determined by reference to economic criteria. Therefore, if the Commission sees it necessary, it may refer to political, sociological and philosophical criteria. However, in practice, it is only economic evaluation of benefit that has been considered.

The Commission's approach in the handling of referred merger cases is unsatisfactory and inconsistent. In the British Motor Corporation and the Pressed Steel merger case, the Commission failed to undertake a detailed and critical study to find out whether the merger was in the public interest. The defendants argued that the merger between the British Motor Corporation and the Pressed Steel Company rested substantially on the likely technical and technological benefits to be obtained. They argued that this was a logical step towards increasing specialization to motor vehicle production. The British Motor Corporation in their defence pointed out the alleged benefits of rationalization of body production - reduction of unit costs, advantages or large-scale, quality improvement and technical advantages in engineering, production, planning and research. Although the defence sound good, yet, the Commission would have probed the alleged benefits by quantitative and/or qualitative research. This it never did, and few onlookers could feel complacent by this unvigorous approach. In the Ross Group and Associated Fisheries merger case, the Commission was rather more thorough in investigating the alleged benefits of the proposed merger. The alleged benefits ranged from those concerned with the modernization of the fishing fleet to those concerned with improvements in marketing and distributing fish.

On the whole, the new powers taken to control and prevent mergers which may be potentially damaging to the public interest may not be fully effective. The Monopolies Commission has failed to live up to the considerable responsibility imposed upon it. As pointed out, the Commission has fared little better in its handling of the benefits to flow from the mergers under investigation. On this point, the writer feels that a period of six months is very short for the Commission to produce a first-class report.

Nevertheless, the power can be invoked to safeguard the public interest at any time. By making it possible to postpone a proposed merger through the "cease and desist" orders, at least, it makes it possible to find evidence to support desirable mergers and information to prevent undesirable ones.

CHAPTER V

SUMMARY AND CONCLUSIONS

The study is based on the economies of horizontal mergers and the public policy of Canada and Great Britain. The study examines the application by the two countries of legislative measures to protect the public interest.

Mergers which lead to an increase in industry concentration may have significant bearing on the degree of monopoly in industry. This is particularly significant when two large firms merge in an oligopolistic industry. Therefore, it is understandable to observe that provisions against mergers are frequently included with those relating to monopoly in anti-combines and monopolies legislation, since at the limit where considerable degree of concentration already exists, a merger may have the result of conferring a substantial monopoly on the merged firm.

The difficulty for public policy in the field of merger legislation lies in the ambiguous effects of mergers. That is, mergers may give rise to increased market power or increased efficiency. Therefore, from the point of view of public policy, it is necessary to separate those mergers which on balance may increase market power and promote economic efficiency from those which realize significant economies and may confer social benefits.

Industrial combinations formed and developed with proper motives can secure many of the economies of large-scale organizations contributing to the industrial progress of a country. Certain characteristics like technological advance, mass-scale production and expanded markets inherent in the modern industrial organization, particularly necessitate the formation of integrated units and integrated firms.

With respect to government policy in the field of anti-combines generally, it has been observed that both Canada and British laws evolved out of the common law of England. However, the inadequacy of the common law to meet the changing business circumstances gave rise to the invention of both systems of control.

However, due to constitutional and other related questions, Canada and Britain have each adopted a different method of control of monopolies and mergers. In Canada, it operates through a legal system where the offence is criminal in nature. The Canadian law prohibits all mergers and monopolies which are or are likely "to operate to the detriment or against the interest of the public." The entire anti-combine statute has been modified on some occasions by changes in the legislation by decisions in case law and by changes in administrative practice.

The British system of control is different. An administrative tribunal - the Monopolies Commission acting on recommendations from the Board of Trade - operates within the framework of civil law, for merger investigations. As it was noted earlier, the British system of control is pragmatic since criteria is set by which mergers are referred to the Monopolies Commission for investigations and recommendations. This position is therefore different from Canada in making explicit the criteria by which mergers are investigated.

Nevertheless, in both countries, very little activity has been carried out against mergers. And even cases which have been investigated results have not been encouraging. The whole procedure for judging mergers is unsatisfactory. The Canadian legislation fails to define the offence clearly. The public interest is in free competition (in some sense) so that the public interest in other aspects of economic policy, such as full employment, economic growth and a sound balance of payments are not open to consideration by the enforcement authorities. Also, Canadian public policy is inconsistent in having a set of detailed enactments denouncing restraints and monopolies, but whose effectiveness is limited, since agreements and mergers are allowed up to the point of virtual monopoly.

In Britain the pragmatic approach has run into considerable difficulty. The Monopolies Commission asked to report only if the merger is against the public interest has been easily satisfied and may have been influenced by the thought that "bad" mergers can be picked up for more thorough and more critical investigation. If the British administrative approach has led to haphazard intervention, the Canadian approach has probably been too narrow. By making mergers under certain circumstances, a criminal offence, Canada made certain that these circumstances would be strictly drawn and made as objective as possible.

<u>Summary</u>

1. This has been a study of the economies of horizontal mergers and the public policy of Canada and Great Britain in the treatment of such mergers. The study examines the use by the two countries of

legislative measures to protect the public interest.

2. Mergers which lead to an increase in industry concentration may have a significant bearing on the degree of monopoly in industry. Therefore in general, provisions against mergers are frequently included with those relating to monopoly in anti-combines or monopolies legislation. At the limit where considerable degree of concentration already exists (for example, when in an oligopolistic industry two large firms merge) a merger may have the result of conferring a substantial degree of monopoly on the merged firm.

3. Both Canadian and British industry have been affected in varying degrees by merger activity; and merger waves have not been of the same magnitude. One of the explanations for the early timing of the merger wave is the development of strong capital markets which aided organizers of mergers to utilize this market.

4. In general, merger per se is not condemned as a form of industrial organization. Thus, the dilemma for public policy in the field of merger legislation lies in the ambiguous effects of mergers. That is a merger may give rise to increased market power or increased efficiency.

5. In both countries the assumption is that no single right structure would be equally applicable to all industries. Industrial combinations formed and developed with proper motives can secure many of the economies of large-scale organizations, contributing to the industrial progress of the country. Certain characteristics like technological advance, mass-scale production and expanded markets inherent in modern industrial organization, particularly necessitate

the formation of integrated units and integrated firms.

6. In the field of anti-trust generally, both Canada and British legislation evolved out of the common law of England. Nevertheless, the inadequacy of the common law to meet the changing business circumstances gave rise to the invention of both systems of control.

7. In the field of anti-combines, Canada has an older legislation dating back to the turn of the century while Britain's legislation is very recent (1948) and in Britain specific merger legislation dates back to 1965. In Britain, apart from the state's promotion of certain monopolies by royal charter, the economic climate at the turn of the century dominated by small family businesses which did not render an early legislation possible, on the contrary in Canada hostility towards monopoly the abuse of monopoly power is known to have existed among the small businessmen and the family community.

8. In spite of the common law background, there are sharp differences in the systems or methods of control of mergers and monopolies in both countries. In Canada, it operates through a legal system where the offence is criminal in nature. Mergers, however, are not a per se offence, and it is only those which are likely to operate to the detriment or against the interest of the public. In Britain, the method is administrative, i.e., an administrative tribunal (Monopolies Commission) operates within the framework of civil law, and any recommendations by the Monopolies Commission are not binding upon the government.

9. In Britain, the government decides what is or is not in the public interest, through its acceptance or rejection of the Monopolies Commission's recommendations, whereas in Canada, the courts in the last resort judges what is or is not in the public interest.

10. In Canada, no specific criteria are given. Hence, mergers or monopolies confer no detrimental effects until virtual or complete monopoly has been secured. In Britain, criteria for judging mergers are given: (a) the monopoly criterion (i.e., one-third supply in any part of the United Kingdom market); and (b) the assets criterion involving mergers of 5 m.

11. Both legislative provisions on the public interest issues are not clearly defined. In the case of Britain, what constitutes the public interest is not spelled out, which gives the Monopolies Commission wide discretion in looking at other factors than economic, and in Canada "public detriment" etc. are not couched in clear language.

12. In both countries, very little activity has been carried out against mergers. And even cases which have been investigated, results have not been very successful. The Canadian legislation is beset with fundamental difficulties of interpretation of words such as "unduly," to "the detriment or against the interest of the public" and so on. The British pragmatic approach has run into considerable difficulties. In practice, the much shorter time given to the Monopolies Commission to complete a merger reference has meant that the enquiries into past behavior and performance of the merging companies have had to be much limited.

Again, the relevant range of relevant considerations that need to be considered if the bearing of a merger on a particular complex market situation is to be properly assessed is very wide and very little weighting and balancing of costs and benefits factor is possible. Thus, the haphazard approach in the British case and the rigidity of the Canadian legislation (proof beyond a reasonable doubt) has led to unsatisfactory results over the years.

13. The unsatisfactory results coupled with very little activity demonstrates that a better method of judging mergers have not yet emerged. In Britain, the government for any set of reasons can withhold a merger reference to the Commission or turn down any recommendations by the Monopolies Commission. In Canada, the Director of Investigations and the courts are working with a different set of criteria.

Conclusions and Recommendations

1. The effective control of mergers requires the adoption of satisfactory control techniques based upon a wider and clearer concept of economic policy.

2. The economies of mergers require that they be evaluated in the light of the economic facts of the national situation if the public interest is to be served.

3. There is a need for more comprehensive public policy for economic development, possibly incorporating overall economic planning to provide coherence, explicitness and continuity in the evaluation of mergers. This avoids the rigidity and extreme conservatism of the Canadian record of performance towards mergers and the ambiguity of British pragmatism.

4. However, on balance an administrative tribunal operating with civil law jurisdiction appears more promising than criminal law which requires proof beyond a reasonable doubt. Nevertheless, the tribunal requires more authority than has been evidenced in the British case.

5. In this regard, the Economic Council of Canada's recommendation for the creation of an administrative tribunal to be known as the "Competitive Practices Tribunal", to reform the present machinery, demands the active support of policy-makers.

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