Submission on Bill C-249

Competition Act Amendments
("Efficiency Defence")

NATIONAL COMPETITION LAW SECTION
CANADIAN BAR ASSOCIATION

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PREFACE

The Canadian Bar Association is a national association representing 38,000 jurists, including lawyers, notaries, law teachers and students, across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the National Competition Law Section of the Canadian Bar Association, with assistance from the Legislation and Law Reform Directorate at the National Office. The submission has been reviewed by the Legislation and Law Reform Committee and approved by the Executive Officers as a public statement by the National Competition Law Section of the Canadian Bar Association.

Submission on Bill C-249
Competition Act Amendments
(“Efficiency Defence”)

The National Competition Law Section of the Canadian Bar Association is pleased to comment on Bill C-249 and its implication for Canadian competition policy. The Section would be pleased to provide additional comments or to respond to additional questions as this amendment process unfolds.

I. INTRODUCTION

Bill C-249 proposes to amend section 96 of the *Competition Act*, which contains the so-called “efficiencies defence” to mergers, by adding two new subsections – namely 96(4) and 96(5).[1] The proposed subsection 96(4) would introduce a limitation to subsection 96(1) and the proposed subsection 96(5) would negate all of section 96 in certain conditions.

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1 The existing subsection 96(1) and proposed subsections 96(4) and 96(5) read as follows:
96(1) The Tribunal shall not make an order under section 92 if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger and that the gains in efficiency would not likely be attained if the order were made.
...
(4) For the purpose of subsection (1), gains in efficiency cannot offset the effects of a lessening or prevention of competition unless the majority of the benefits derived or to be derived from such gains in efficiency are being or are likely to be passed on to customers within a reasonable time in the form of lower prices.
(5) This section does not apply where, after the transaction has been completed, the merger or proposed merger, will result or is likely to result in the creation or strengthening of a dominant market position.

This submission examines the proposed subsections 96(4) and (5) and their potential impact on competition policy and specifically on merger enforcement in Canada. Part II of this submission summarizes our views in an executive summary. Part III reviews the history or origin of section 96 in its current form. Part IV discusses the proposed amendment to subsection 96(4). Part V discusses the proposed amendment to subsection 96(5). Part VI reviews the Section's understanding of the policy impetus for the amendments and some common misapprehensions concerning the operation of Section 96 in its current form. Part VII contains our conclusions.

II. EXECUTIVE SUMMARY

Subsection 96(1) was included in the *Competition Act* to ensure that Canada's economic resources are used to their maximum efficiency, for the greater well-being of all Canadians. The goal was to maximize the size of the "pie". Parliament explicitly recognized that other policy tools are better suited to redistributing the portions of the pie if so desired.

In the Section's view, Parliament ought not to emasculate section 96 by passing the proposed amendments. Subsection 96(4) would serve only to block mergers that otherwise would have benefited the Canadian economy as a whole. Subsection 96(5) would likely make the efficiencies defence inaccessible for the very mergers for which it is intended. Indeed, it amounts essentially to the deletion of section 96 from the *Act*.

It is impossible to assess the benefits and costs of the efficiencies defence, or of the amendment that seeks essentially to erase it, without an eye to the inescapable fact that the Canadian economy is more and more enmeshed in competition that transcends borders. Efficiency gains are additional strengths not only within the Canadian economy but, more and more, to the Canadian economy as a competitive supplier to the world.

The amendments to the *Competition Act* proposed by Bill C-249 appear to be guided – at least in part – by certain widespread misapprehensions about the economic import of the current language in subsection 96(1) of the *Act*. In any event, in practical terms, subsection 96(1) – even in its current form – is very seldom used. In over 15 years, only one case has gone to the Competition Tribunal in which efficiencies was the deciding factor. The current subsection cannot be said to have resulted in a wave of mergers that harm consumers or result in dominant positions.

Finally, in the view of the Section, it is premature for the Standing Committee on Industry, Science and Technology (the Committee) to consider passage of this Bill. There is ongoing litigation concerning the scope of the current subsection 96(1). Also, the Committee has recommended forming an independent task force to study these very issues.

III. CURRENT MERGER PROVISIONS

Section 92 of the *Competition Act* permits the Competition Tribunal to prevent or unwind, in whole or in part, mergers that prevent or lessen – or are likely to prevent or lessen – competition substantially in a relevant competition market.[2] Subsection 96(1) provides an exception or "defence" for mergers that would otherwise be found to cause a substantial lessening of competition under section 92. Specifically, subsection 96(1) prohibits the Tribunal from making an order under section 92 if it finds that the gains in efficiency from the merger are likely to be "greater than" and to "offset" the effects of any lessening of competition. The Tribunal must also find that such efficiencies are not likely to be achieved in the absence of the merger.

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2 In this submission, we will refer to this standard as "a substantial lessening of competition".

In essence, the proposed amendments are designed to make section 96 less available as a defence to an otherwise anti-competitive merger.

This is ironic in itself. Of the more than 2000 mergers reviewed by the Competition Bureau during the 15 year history of section 96, only one case has come before the Competition Tribunal in which it was asked to justify an otherwise anti-competitive merger on the basis of efficiencies.[3] In its report entitled *A Plan to Modernize Canada's Competition Regime*, the Committee noted that "the Commissioner has not even once found the efficiency gains to a merger proposal sufficient to offset any lessening of substantial competition". Clearly, section 96 in its current form has not opened the floodgates to anti-competitive mergers.

Subsection 96(1) resulted from a lengthy and considered consultation and amendment process. It reflects a consensus among policy-makers and the business and legal communities regarding the most appropriate method of balancing efficiencies and anti-competitive effects resulting from a merger. The genesis of the current section 96 was the 1969 *Interim Report on Competition Policy of the Economic Council of Canada* (the ECC Report), which emphasized the importance of economic efficiency to a small, open economy like Canada's. According to the ECC Report:

> Essentially, we are advocating the adoption of a single objective for competition policy: the improvement of economic efficiency and the avoidance of economic waste, with a view to enhancing the well-being of Canadians...

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3 *Commissioner of Competition v. Superior Propane*, 2000 Comp. Trib. 15 (August 30, 2000). Note that the Competition Tribunal briefly commented on section 96 of the *Act* in *Director of Investigation and Research (Canada) v. Hillsdown Holdings (Canada) Limited* CT-91/01 (March, 1992).

> This concentration on one objective is not meant to imply any necessary disparagement of other objectives, such as more equitable distribution of income and the diffusion of economic power, which have been entertained for competition policy in the past. It is simply that we believe:
>
> (1) that a competition policy concentrated on the efficiency objective is likely to be applied more consistently and effectively; and
> (2) that there exist more comprehensive and faster-working instruments, particularly the tax system and the structure of transfer payments, for accomplishing the deliberate redistribution of income and the diffusion of economic power, to whatever extent these are thought to be desirable.

The amendments contemplated in Bill C-249 are not new, and were indeed considered and rejected in the process of developing the existing section 96. In particular, the language of proposed subsection 96(4) (the "passing on" requirement) derives almost directly from Bill C-256, which was not adopted.[4] Bill C-42, the next attempt at reform, dropped the "passing on" requirement, but contained language similar to proposed subsection 96(5). That proposed amendment would have made the efficiency defence unavailable if the merger was likely to result in "virtually complete control" of a market. The next attempt at reform, Bill C-13, contained similar language. None of these was adopted. It is noteworthy that the preamble to the current *Competition Act* specifically omits the concern with distributional equity contained in the preambles of Bills C-256, C-42 and C-13.

The current debate over the efficiencies defence was ignited by the *Superior Propane* case. Prior to *Superior Propane*, the Competition Bureau had adopted the total surplus standard (also known as the total welfare approach) in interpreting and enforcing section 96. This position was articulated in Part 5 of the Bureau's *Merger Enforcement Guidelines* and reiterated in the *Merger*

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4 Paragraph 34(3)(ii) proposed in Bill C-256 provided that

> a substantial part of the benefits derived or to be derived from such improvement of efficiency are being or are likely to be passed on, through conditions imposed by the market or by order of the Tribunal, to the public within a reasonable time in the form of lower prices or better products.

Enforcement Guidelines as Applied to a Bank Merger. The rationale for the total surplus standard is firmly grounded in economics and focuses on whether a merger makes society as a whole wealthier, judging by the net effects of a merger on society's use of its economic resources. Mergers are permitted under this standard, where:

1) the likely gains to society as a whole, as a result of the efficiencies made possible by the merger in terms of cost (or resource) savings (i.e., the benefits of freeing up resources for more valued purposes)

exceed

2) the loss known as the "deadweight loss" to society from the anti-competitive effect of the merger should the merged parties increase prices and reduce output of certain products, thus causing a misallocation of resources caused by the merger's anti-competitive effects (i.e., the loss from consumers switching to inferior or "next best" substitutes because of, for example, price increases relating to the merging parties' products).

Stated in other terms, when an efficiency-enhancing merger also results in a price increase, in addition to the wealth increase due to efficiencies, it gives rise to both a wealth transfer from consumers to producers or shareholders due to higher prices and an absolute decrease in wealth due to a shift of some resources to the production of products less desired by society (a deadweight loss). However, the total surplus standard does not place a value on the wealth transfer from consumers to producers or shareholders. Instead, it views this redistribution as neutral because it is difficult to judge in advance who is more deserving of its benefits – consumers or the people that would own shares in the merged company.[5] In this analysis, "consumers" may include large corporations as well as individual consumers, depending on the product, just as "shareholders" may include Canadian pension funds or large multinationals.

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[5] For a fuller discussion of the economics, see Donald G. McFetridge (1996) "The Efficiencies Defense in Merger Cases", in *Competition Policy Enforcement: The Economics of the Antitrust Process* (Malcolm Coate and Andrew Kleit eds.).

In *Superior Propane*, however, the Bureau reversed its approach and took the view that the redistributive effects of a merger are not always neutral. The Bureau advocated a "balancing weights" approach to measuring the anti-competitive effects of a merger. This would see the Tribunal assign different weights to consumers and producers, depending on the circumstances of each case, rather than assume that any redistribution of wealth had a neutral impact on the economy.

Superior Propane is still before the courts[6] and it would not be appropriate to comment on the merits of the parties' positions. Suffice it to say that Bill C-249 proposes amendments designed, in essence, to ensure that the efficiency defence would never be available for a merger that redistributes income from consumers to producers (proposed subsection 96(4)) nor for one that creates or strengthens dominant positions, even if consumers would likely benefit from lower prices as a result of the merger.

In our view, consideration of the issues raised in Bill C-249 should proceed in accordance with the following recommendation from the Committee's Plan to Modernize Canada's Competition Regime:

> 28. That the Government of Canada immediately establish an independent task force of experts to study the role that efficiencies should play in all civilly reviewable sections of the *Competition Act*, and that the report of the task force be submitted to a parliamentary committee for further study within six months of the tabling of this report.

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6 In a decision issued on April 4, 2001, the Federal Court of Appeal remanded the case for re-consideration by the Tribunal, with instructions to consider not just the "dead-weight loss", but all of the effects of the merger. The decision of the Tribunal on remand was issued on April 4, 2002, and that decision, like its predecessor, has also been appealed by the Commissioner.

IV. PROPOSED SUBSECTION 96(4)

The Section opposes the proposed subsection 96(4) because it would prevent some mergers that would otherwise benefit the Canadian economy as a whole. Moreover, it is difficult and inefficient to use merger policy to redistribute income between classes of individuals, even when redistribution of income is one of society's general goals.

Such an activist approach to merger policy is unwarranted. Merger policy is designed to maximise the wealth of society and to ensure that resources are allocated to their most valued use. If the government desires to redistribute the wealth that results, there are clearly more effective tools open to the government than the *ad hoc* prevention of certain mergers. Other more direct government policy tools for the redistribution of resources – if such is the policy goal – include taxation on income and goods and services, foreign ownership restrictions, price regulation, environmental regulation, employment standards, regional development policies and national health care (to name a few). Clearly such measures – if desired – will be more effective at redistributing wealth than will the occasional prevention of an otherwise wealth-maximising merger.

Even judged as a tool for ensuring wealth is not re-distributed away from the less advantaged as a result of a particular merger, the proposed amendments fail. Proposed subsection 96(4) would not just alter the interpretation of subsection 96(1) beyond the traditional total welfare interpretation; it would even go beyond even the interpretation of the Federal Court of Appeal in the *Superior Propane* case. Contrary to the intention of the Federal Court of Appeal, the proposed approach is inflexible and would always weigh consumer welfare more heavily than producer or shareholder welfare regardless of who would actually fall within these two categories.

There is no doubt that this amendment would represent a fundamental change in the approach to, and goals of, Canadian competition policy. It moves away from the longstanding and considered position that efficiency is the paramount objective of Canadian merger policy, leaving redistribution of income to other policy tools. Moreover, it presumes without justification that consumers are always less advantaged than producers or shareholders.

The Section also believes that such an amendment is largely unnecessary. In this regard, we repeat the testimony of Mr. Domm before Legislative Committee on Bill C-91:

> Regarding [the] concern . . . that there is no obligation to pass gains on to the consumer [in the current bill], . . . such an obligation can be very difficult to objectively measure or to monitor, and unless the lessening of competition is overwhelming, competition in the market will result in gains passed on to consumers.[7]

V. PROPOSED SUBSECTION 96(5)

Proposed subsection 96(5) would provide that section 96 could not apply in cases where the merger is likely to result in the creation or strengthening of a dominant market position. In the Section's view, such an amendment would likely vitiate section 96. The Section does not support this goal. If the government nonetheless desires to render section 96 ineffective, a clearer and more transparent way to achieve this end would be simply to delete subsection 96 or to move efficiencies into section 93 as a factor to be considered when assessing the competitive effect of a merger.

An understanding of the implications of proposed subsection 96(5) requires an interpretation of "dominant market position". "Dominant" is generally accepted to mean a firm that has substantial "market power", where market power is the

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7 Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-91 (Issue No. 11, Wednesday, May 21, 1986 at 11:38-11:42)

ability to raise prices in a non-transitory (i.e. sustained) fashion (or similarly affect non-price elements of competition). In the *Laidlaw* case, which contains the only statement from the Competition Tribunal on the level of market share that might signify dominance, the Tribunal observed that a market share of less than 50 percent would not give rise to a *prima facie* finding of dominance. In the Bureau's *Enforcement Guidelines on the Abuse of Dominance Provisions* (issued August 2001) the Bureau states that it would not normally investigate an abuse of dominance claim where the market share was less than 35 percent.

There are two possible interpretations of the intent of proposed subsection 96(5). The first is that any merger that creates market power (say, with a lower boundary of 35% post-merger market share), will not have access to the efficiency exception of section 96. This interpretation would vitiate the utility of section 96 in its entirety, as section 96 only comes into play if the Tribunal has otherwise found a merger to substantially lessen competition – a finding which is synonymous with the creation or strengthening of a dominant position. Again, if this is the objective, abolishing section 96 would be a much more direct and transparent method of achieving this outcome.

The second possible interpretation may be to prevent "mergers to monopoly" or "mergers to near-monopoly" under any circumstances, no matter how large the projected efficiency gains. As a policy objective, this is unwise. For one thing, although the term "monopoly" is popular with media commentators and in general discussion, it is not a concept that has any precise meaning in economic theory.[8] In reality, almost all products and services have some substitute or

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8 Whenever we observe a downward sloping demand curve, even for a so-called "monopolist", we know that an increase in the price of that good will lead to consumers switching away to other, substitute goods (unless demand is perfectly inelastic, which is very unlikely) or simply deciding not to spend their money. In light of this, economists have undertaken considerable effort to devise precise ways of measuring market power (based on the elasticity of demand) that do not specifically depend on the identification of a "monopoly". A discussion of the vagueness of the term "monopoly" can be found in Roger Ware, "Efficiencies and the Propane Case" (2000) 3 *International Antitrust Bulletin* at 17-19.

threatened substitute, and very few firms have close to 100% market share of a properly defined market.

In any event, as explained in more detail below in markets that are already concentrated, it is more likely there is pre-existing market power. This means it is less likely that a merger in that market will pass the total surplus test or "balancing weights" test in any case. A proper application of either of these tests would already likely prohibit these types of mergers.

VI. BACK TO BASICS

Before Parliament decides to change the approach to section 96 through the amendments proposed in Bill C-249, it should first address the question of why such change is necessary.

The Government, of course, can change Canadian merger law to favour consumers over producers. However, in the Section's view, it should not do so under the misapprehension that current merger law and section 96 as it stands – interpreted under either the total surplus standard or the "balancing weights" approach – generally permits those types of mergers.

In part, these misapprehensions have developed from the belief that the total surplus standard articulated in the Merger Enforcement Guidelines, for example, more easily permits mergers that would create monopolies or near monopolies than other smaller mergers. This is because relatively small cost savings (efficiencies) could almost always save an exceptionally anti-competitive merger with large price effects. This misunderstanding is often based on the simplified original modelling of the efficiency trade-off problem when it was initially contemplated in the economics literature in the late 1960s.[9] The basic message

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[9] Oliver E. Williamson, "Economics as an Antitrust Defense: The Welfare Tradeoff" (1968) 58 Economic Review 18.

behind the simplified original economic model was to recognize the potential benefits of mergers (i.e., cost savings or efficiencies) in addition to their costs (i.e., anti-competitive effects). Despite the simplicity of the original economic model, however, any application of the theory requires a more complex and thorough analysis. Thus, when actually measuring such benefits or such anti-competitive effects, one must extend the original work to account for other factors, including any pre-existing market power as well as the likely marketplace response by other firms to the merger.

More refined economic analysis has shown that, in practical terms, the greater the amount of pre-existing market power (which is more likely in cases where the market is already concentrated and the possibility of a merger to monopoly is greater), the greater must be the merger efficiencies in order to offset the resulting deadweight loss – even following the total surplus standard. As a consequence, contrary to the misapprehension described above, the more closely a merger approaches a merger to monopoly, the less likely that its efficiencies will offset the resulting welfare loss. If the application of merger law fails to account for pre-existing market power when determining the applicability of section 96, this cannot be due to the wording of the law, but rather an oversight in the enforcement process.

Some have argued that the current merger provisions cannot take into account losses in welfare that are not price-related – for example, decreases in product or service quality, availability or variety. Some believe that these types of welfare losses would not be taken into account in determining whether the loss in welfare is offset by the efficiencies. In fact, this is not the case. In assessing whether there is a substantial lessening of competition, there is nothing in the current merger provisions that limits considerations only to those involving price. In addition, the *Merger Enforcement Guidelines* clearly contemplate considering non-price elements of competition in the efficiency trade-off analysis. Specifically, section 5.4 of these guidelines states:

> The expression "greater than" and "offset" are considered to each have qualitative and quantitative connotations. That is to say, the efficiency gains must be greater than the anti-competitive effects that are likely to result from the merger, in both a qualitative and quantitative sense; and the efficiency gains must offset these anti-competitive effects, in both a qualitative and quantitative sense.

Again, if the application of merger law in specific cases has failed to account for qualitative harm to consumers when determining whether the criteria for an offset have been met (which we think not to be the case), this cannot be a problem with the wording of the law, but must have to do with the enforcement process.

In sum, the proposed amendments would fundamentally change the approach to Canadian merger policy in that they involve a conscious decision to prejudge that a dollar in consumers' hands will always be worth more than a dollar in the hands of producers or shareholders. Moreover, the resultant provisions would lack sufficient flexibility to permit some mergers that are otherwise welfare-enhancing – in other words, mergers that would otherwise be of benefit to the Canadian economy as a whole.

In our view, any amendments of such a far-reaching nature should be the subject of a proper consultation process in which the views of all stakeholders are adequately considered.

Such a departure from the objective of economic efficiency in merger policy would lead inevitably to decisions that reduce the wealth of Canadians as a whole. That is, proposed mergers that would have increased the net wealth of Canadians would be blocked because they do not meet a stringent consumer welfare standard. Canadian merger policy, which is devoted to economic efficiency, would be used – at least on occasion – to frustrate that goal.

Rendering irrelevant to merger analysis the merger's efficiency gains would be especially detrimental to a small export economy such as Canada's, which needs to promote the utmost efficiency of its industry in order to compete and win on the world stage.

In any event, should Parliament decide to adopt amendments such as those proposed in Bill C-249, and thus fundamentally change Canada's approach to mergers, the Section hopes that it will not do so under the misapprehensions set out above.

VII. CONCLUSION

For all of the foregoing reasons, the Section strongly urges Parliament not to adopt Bill C-249. Should the Committee have additional questions, we would be pleased to respond.