Submission on Bill C-249 — Proposed Amendment to the Section 96 of the *Competition Act* (Merger Efficiency Defence)

NATIONAL COMPETITION LAW SECTION
CANADIAN BAR ASSOCIATION

October 2003

TABLE OF CONTENTS

Submission on Bill C-249 — Proposed Amendment to the Section 96 of the *Competition Act* (Merger Efficiency Defence)

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 as a public statement of the National Competition Law Section of the Canadian Bar Association.

Submission on Bill C-249 — Proposed Amendment to the Section 96 of the *Competition Act* (Merger Efficiency Defence)

I. INTRODUCTION

The National Competition Law Section of the Canadian Bar Association (the CBA Section) is pleased to provide its comments on Bill C-249 (an Act to amend the *Competition Act*) to the Senate Committee on Banking, Trade and Commerce.

Bill C-249 proposes to amend section 96 of the *Competition Act,* the so-called merger efficiencies defence, by replacing its existing subsection (1).

The CBA Section welcomes the opportunity to present its views on this important legislative initiative and it appreciates the interest that the Senate Committee has exhibited in effecting improvements to Canadian competition law. The CBA Section has strongly-held views on the importance of efficiencies in competition law analysis. In particular, it is concerned that efficiencies are not being given appropriate consideration, not only in the context of merger review, but also with regard to many other provisions (a matter for discussion for another day).

This submission positions the CBA Section's comments on the Bill as presented to the Senate Committee. However, given the importance of efficiencies in competition law, in particular in regard to mergers, our expressed preference would be to examine the changes proposed by Bill C-249 as part of the current

public consultation process on significant proposed reforms to the *Competition Act*[1] (the Discussion Paper).

If, notwithstanding the CBA Section's views, it is determined to proceed with Bill C-249 in its present form, the CBA Section has significant concerns about the limitation on the recognition of efficiencies for this purpose. These concerns are more specifically set forth below.

II. 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 competition substantially in any relevant market, or are likely to do so. In its present form, subsection 96(1) provides an exception or "defence" for mergers that would otherwise be found to give rise to a substantial prevention or lessening of competition under section 92. Specifically, subsection 96(1) prohibits the Tribunal from making an order against the merger under section 92 if it finds that the gains in efficiency from the merger are likely to be "greater than" and to "offset" the adverse effects of any lessening of competition. The Tribunal must also determine that such efficiencies are unlikely to be achieved in the absence of the merger.

The amendment posed by Bill C-249 would replace the current merger efficiency defence with a "factoral" approach to the consideration of efficiencies. The proposed approach would substantially change the potentially over-riding role of efficiencies in merger review to one in which efficiencies would become one of a number of factors (such as ease of entry and the strength of remaining competition) to be taken into account in determining whether a merger gives rise to a substantial lessening of competition. Specifically, the proposed amendment

1 As set forth in the Government's Discussion Paper, "Options for Amending the *Competition Act*: Fostering a Competitive

would authorize the Tribunal, when considering the legality of a proposed merger under section 92, to consider, in conjunction with the other factors in section 93, whether the merger or proposed merger has brought about or is likely to bring about efficiency gains that will benefit consumers, including competitive prices or product choices, and that would not likely be attained in the absence of the merger or proposed merger.

No mention is made in the Bill to the status of subsections 96 (2) and (3), which presumably means that those subsections are to be preserved in the context of a new amendment.

III. *SUPERIOR PROPANE* CASE

The proposed amendment needs to be considered in the context of the decision in *Superior Propane*.[2] Without getting into all its detail, *Superior Propane* is the only case in the history of the section 96 merger efficiency defence where the defence has been successfully invoked in a merger which, in all other respects, gave rise to a substantial lessening of competition (i.e., where the efficiencies generated by the proposed merger were held to override its anti-competitive effects).

One reason why the provision has not been invoked more frequently is, in part, due to its being a defence. It is only considered after a substantial lessening of competition is determined likely to arise. We also believe there has been a reluctance on the part of the Competition Bureau to accept that efficiencies should enable a merger which does substantially lessen competition to go ahead, notwithstanding its anti-competitive effects. Accordingly, the role played by

Marketplace", June 2003.

2 *Canada* (*Commissioner of Competition) v. Superior Propane*, 2000 Comp. Trib. 15 (August 30, 2000); 2001 199 D.L.R. (4th) 130 (Fed. Ct. of Ap.); 2000 Comp/ Trib. 16 (April 4, 2002) and 2003 F.C.A. 53 (FCA).

efficiencies in merger review during the 16 years that the defence has been available appears to have been marginal, at best.

While the Tribunal's decision in this case may be thought to enlarge the scope of its operation, that does not seem to us to be very likely. Firstly, the Tribunal's decision requires that, for the defence to be applicable, the efficiencies must outweigh and offset not only the "deadweight loss" but also that portion of the increased price representing the wealth transfer likely to be brought about by the merger which is judged to be "socially adverse". The identification and measurement of those elements pose enormous challenges, to say nothing of the significant uncertainties, involved in forecasting when the defence might be available.

Beyond that, the actual scope for invoking the defence appears to be quite limited. There is apparent agreement amongst knowledgeable economists that had the deadweight loss in *Superior Propane* been properly calculated (rather than under-valued), the efficiency gains would not have offset it (let alone any socially adverse wealth transfer). Thus, it appears that the defence should not even have been available in that case.

In the CBA Section's view, there is no crisis brought about by the Tribunal's interpretation of section 96 in *Superior Propane*. There is little real prospect of merger-facilitated monopolies running rampant in the economy as a consequence of this decision.

Indeed, our concern is not that the current section 96 goes too far. Rather, because it is of such limited scope, it has effectively marginalized the consideration of efficiencies in merger review. Its "all or nothing" positioning in the merger review process is not, in our view, helpful in giving efficiencies their due in merger review. Whether or not one agrees with the Tribunal in its characterization of efficiency as the Act's paramount objective, it clearly is an

important purpose of the legislation. Therefore, to the extent that efficiencies are not being considered in merger analysis this is not merely unfortunate. It is, in our view, a miscarriage of the Act's purpose.

IV. PUBLIC CONSULTATION

Attaining economic efficiency is a key goal of competition law and policy. It is therefore critical that its proper role be carefully considered and appropriately provided for in the law. This is particularly the case for mergers, as the attainment of superior economic efficiency is frequently a primary objective of merger transactions. Given the importance of this subject in the context of competition law generally, it is desirable that any proposal to effect such a significant change relating to efficiencies be appropriately considered as part of a public consultation process, in which the views of all significant stakeholders are duly considered.

Such a public consultation process is currently underway to consider other significant reforms to the *Competition Act* proposed in the Discussion Paper, facilitated by the Public Policy Forum (PPF). In the view of the CBA Section, it would be preferable if the amendments to the merger efficiency defence proposed by Bill C-249 were instead considered as part of the PPF's public consultation process. If such amendments continue to commend themselves following the consultation process, they could be brought forward (with any revisions considered appropriate) as part of the larger group of reforms coming forward from the Discussion Paper proposals. It may be that the amendments proposed by Bill C-249 are the preferred approach. The CBA Section is inclined to support them, subject to the elimination of two limiting features which are regarded as undesirable. However, the fact is that these particular reforms have not had the benefit of the significant public consultation appropriate to such an important

subject. As a result, it would be desirable to include the amendments proposed by Bill C-249 in the overall package of amendments proposed by the Discussion Paper in the current public consultation process.

V. PROPOSED AMENDMENT

For these reasons and because, in our view, efficiencies are not being accorded sufficient consideration in the context of merger review as it is presently conducted under the Act, the CBA Section supports a legislative change which would treat efficiencies as one factor in determining whether a particular merger may give rise to a substantial prevention or lessening of competition. We expect that there would be a greater willingness on the part of both the Bureau and the Tribunal to consider efficiencies for this purpose where efficiencies are not likely on their own to be decisive concerning the legality of the merger. We think that efficiencies, when treated as a factor to be taken into consideration in merger review (rather than as an outright affirmative defence), will also likely be regarded with considerably less hostility than is presently the case. We also agree that integration of the efficiencies into a competitive effects analysis in merger cases is the desirable direction to go, although we do have significant concerns (discussed below) about the limitations the Bill proposes to attach to their recognition for this purpose.

Also, what is proposed will more closely parallel the approach taken in the United States[3] and appears to be proposed in the EU in regard to the treatment of efficiencies in merger review. That result alone is a desirable objective from an international convergence perspective.

While we do not expect that efficiencies would ever be decisive so as to permit a

3 1992 Joint Department of Justice/Federal Trade Commission Horizontal Merger Guidelines, as revised in 1997 (the Revised

merger to monopoly, there are a number of circumstances in which the pro-competitive effects of an efficiency-enhancing merger could lead the Bureau or the Tribunal to conclude that the merger would not be anti-competitive. Examining whether a merger may give rise to efficiencies can assist in determining whether it is likely to lead to higher prices or other adverse competitive effects. Indeed, an appreciation of merger efficiencies will likely be helpful in understanding whether the merged firm will have an incentive to raise prices, having regard to the effect of the merger on the merged firm's costs. Parties may be able to show, because of expected efficiencies, that their merger will enable the merged firm to compete more effectively against other more significant competitors, thereby driving industry prices down rather than raising them.

In addition, efficiencies are not limited to production cost savings (although those often are the most obvious type of efficiencies). Other efficiencies that may have positive or pro-competitive effects include the combination of complementary assets or resources that give rise to synergies and expand the reach and effectiveness of the merged business. Dynamic efficiencies (the pressure that a merged firm may impose on rivals to become similarly efficient) are another example. All these positive benefits could, it seems to us, be considered more effectively (and with a greater practical prospect of being recognized) in the context of a provision that treats efficiencies as a factor.

VI. UNDULY RESTRICTIVE LIMITATIONS

While the CBA Section supports the proposal to integrate efficiencies as a factor into competitive effects merger analysis (resulting, we believe, in greater and more appropriate recognition of efficiencies in merger review), we oppose the two significant limitations on their recognition that the Bill proposes.

Merger Guidelines).

Firstly, the proposed amendment would limit consideration of efficiencies to those where consumers benefit (including through competitive prices and product choices). Since any merger efficiencies would first be realized upstream of consumers, it would also be necessary to demonstrate that the benefit of those efficiencies is likely to be passed on to consumers by the merged business.

It is difficult to understand why this should be the case. Firstly, it gives rise to a further difficulty of proof (beyond that of showing that the merger will actually generate the efficiencies in question). Imposing this limitation on the recognition of merger efficiencies will inevitably lead to a range of potentially important efficiencies — such as productivity improvements, innovation gains, dynamic efficiencies and synergies arising from the combination of complementary assets — being effectively ignored because of difficulties in demonstrating they will be passed on to the benefit of ultimate consumers. More importantly, it raises the question of why a proposed merger that will increase the net wealth to the Canadian economy as a whole (through generating efficiencies by whomever they may be enjoyed) should not proceed because it does not meet a stringent consumer welfare standard. Not even the U.S. enforcement agencies apply a strict consumer welfare test[4]. Accordingly, this limitation should be removed and the issue should be left to the discretion of the Tribunal to determine in accordance with the purpose clause in section 1.1 of the Act.[5]

The other limitation proposed by the Bill, namely that the efficiencies must be shown to be merger specific (i.e., not likely achievable any other way), presents

4 Footnote 37 of the Revised Merger Guidelines does not apply a strict consumer welfare test to efficiencies claims. It states that efficiencies will be considered even if they do not have a direct, short-term effect on price.

5 Section 1.1 of the Act provides:

> *Purpose* – The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices.

significant difficulties of proof that may prevent the recognition of efficiencies. It is arguably also unnecessary, given that efficiencies will form just one part of an overall mix of considerations in the merger assessment process. The limitation implies a requirement to prove the negative, which is notoriously difficult to do. Mergers are frequently the way in which firms achieve efficiencies. Certain types of efficiencies, such as scale economies, might fail the merger specificity test. As has been suggested elsewhere[6], competition authorities (and the courts) should not force firms to choose less desirable means of achieving efficiencies, or to forego them altogether, because of some theoretical possibility that the firms might achieve the efficiencies through some means other than their proposed merger. It is hard to understand why merger specificity should be required in circumstances where it is clear that the efficiencies will enhance competition. The CBA Section would prefer to see this limitation removed as well, although it recognizes that a similar requirement has applied to the existing merger efficiency defence. Despite the fact that the present merger efficiency defence contains a similar requirement, the CBA Section strongly recommends that this limitation also be removed if the amendments proposed by Bill C-249 go forward.

VII. OTHER COMMENTS

If efficiency is to be a factor, it ought logically to be incorporated into the existing list of merger review factors in section 93.

In any event, whether proposed subsection 96(1) is preserved or is converted to a factor under section 93, subsections 96 (2) and (3) ought to be deleted. Those subsections tend to confuse, rather than clarify, the application of efficiencies and in the context of a factoral provision (as opposed to a defence which may trump adverse anti-competitive effects), are essentially unneeded.

6 Ilene Knable Gotts and Calvin S. Goldman, Q.C.: "The Role of Efficiencies in M&A Global Antitrust Review: Still in Flux?" (2002 Fordham Corporate Law Institute, 29th Annual Conference on International Antitrust Law and Policy Proceedings.

VIII. CONCLUSION

In summary:

- Given the importance of the proposed change, the CBA Section considers it preferable to include it in the public consultation process on the Discussion Paper, to obtain the views of affected and interested members of the public;
- The CBA Section supports the proposed treatment of efficiencies, as a factor to be taken into consideration along with the other factors in section 93, in assessing the legality of mergers under the Act;
- The CBA Section does not support the inclusion of the limitations in the proposed amendment to subsection 96(1) which would confine the recognition of efficiencies to those which are likely to benefit only consumers and those that are demonstrably merger-specific; and
- The CBA Section would prefer that the proposed amendment be re-designed as an additional factor under section 93, and recommends that subsections 96 (2) and (3) be deleted, wherever the proposed amending provision is ultimately located in the Act.