Draft Bulletin on Efficiencies in Merger Review

NATIONAL COMPETITION LAW SECTION
CANADIAN BAR ASSOCIATION

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PREFACE

The Canadian Bar Association (CBA) is a national association representing 37,000 jurists, including lawyers, notaries, law teachers and students across Canada. The CBA'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 CBA, 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.

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Draft Bulletin on Efficiencies in Merger Review

I. INTRODUCTION

The National Competition Law Section of the Canadian Bar Association (the CBA Section) welcomes the opportunity to comment on the *Draft Bulletin on Efficiencies in Merger Review* (the Bulletin) issued by the Competition Bureau. The CBA Section supports the Bureau's efforts to articulate its views on the application of the *Competition Act* to business conduct by publishing enforcement guidelines, information bulletins, speeches, press releases and other interpretive aids.

Overall, the CBA Section supports additional guidance in the area of merger efficiencies, and the willingness of the Commissioner of Competition and the Bureau to consider evidence and submissions relating to efficiencies at an early stage. Additional guidance is particularly necessary in the area of how efficiencies may affect the Bureau's analysis of proposed mergers given the important role they are intended to play in Canada. As recognized in the 2005 Report of the Advisory Panel on Efficiencies, there currently is a significant level of uncertainty in the business and legal communities regarding the Bureau's approach to efficiencies in merger review.[1]

Additional guidance in this area is also timely, in that the Competition Policy Review Panel, echoing the comments of the Advisory Panel on Efficiencies, recently emphasized the importance of achieving efficiencies through mergers and recommended that the Bureau review mergers with efficiencies in mind from the outset.[2] The CBA Section also commends the Bureau for confirming that it will not necessarily resort to the Competition

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[1] Report of the Advisory Panel on Efficiencies, August 2005, at p. 54.

[2] *Compete to Win*, Final Report of the Competition Policy Review Panel, June 2008 (Ottawa: Industry Canada, 2008), at p. 56.

Tribunal for the adjudication of merger efficiencies under section 96 of the *Competition Act*. In this regard, it would be helpful if the Bureau clarified that it will not resort to the Tribunal when the Commissioner is satisfied that the elements of section 96 have been met.

In summary, while the CBA Section agrees with many of the positions and suggestions outlined in the Bulletin, there are a number of areas where the CBA Section has different views or notes that additional clarification might be helpful. In addition, the CBA Section believes that refinements of the Bureau's views on the treatment of efficiencies should be added to the *Merger Enforcement Guidelines* (MEGs), rather than published in a separate enforcement bulletin.

II. GENERAL COMMENT – AMENDING THE MEGS IS A BETTER APPROACH

While not binding as a matter of law, the MEGs[3] are the Bureau's primary pronouncement on its analytical approach to merger review. Part 8 of the MEGs deals with "The Efficiency Exception." However, when the MEGs were issued in September 2004, there was considerable uncertainty about the future of Canada's efficiency defence. It has been understood by some in the legal and business community that Part 8 of the MEGs is preliminary and subject to further development based on the evolution of the Bureau's enforcement approach following *Superior Propane* and the outcome of its efficiencies consultations. The Bulletin develops the approach outlined in the MEGs with certain helpful additional guidance on efficiencies. However, it is also duplicative of the MEGs, and in some instances (highlighted below), inconsistent with the MEGs. It also seems incongruent for the MEGs to contain a comprehensive review of the Bureau's approach to the assessment of the competitive effects of a merger, but only a partial review of its treatment of efficiencies when, as a legislative matter, efficiencies are to be given at least equal, if not paramount, consideration as part of the merger review framework in Canada. By providing guidance in a supplementary enforcement Bulletin, the Bureau risks creating the perception that the points are subordinate to those in the MEGs. These considerations,

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[3] In this submission, references to the MEGs are to the 2004 version. However, the CBA Section notes that the 2004 MEGs supersede the 1991 MEGs only to the extent of any inconsistency.

along with the ease of reference in having one document as the source of the Bureau's views, strongly support placing all guidance on the merger review process into the MEGs.

III. SPECIFIC COMMENTS

A. Scope for Consideration of Efficiencies as Part of the Competitive Effects Analysis

The Bulletin relies on § 137 of the Redetermination Decision in *Superior Propane*, where the Tribunal wrote that "[i]t is plainly Parliament's intent that, in merger review, efficiencies are to be considered only under section 96 and not under section 92."[4] The CBA Section believes that the consideration of efficiencies under sections 92 and 96 is not an "either/or" proposition. Rather, in appropriate cases, it is incumbent on the Bureau to consider efficiencies both as part of the competitive analysis (for example, where the costs savings achieved through a merger would impact directly on the competitive dynamics in a market) and if, after taking this and the other factors in section 93 into account, there is a finding that competition is likely to be substantially prevented or lessened, making a broader assessment of efficiencies under section 96.

Efficiencies are relevant under section 92 for a number of reasons. First, the Tribunal's statement above was *obiter dicta*.[5] Second, section 93 provides that in determining whether a proposed merger is likely to prevent or lessen competition substantially, the Tribunal may have regard to certain enumerated factors, including under paragraph 93(g) "the nature and extent of change and innovation in a relevant market" (which is a clear reference to efficiencies, including dynamic efficiencies) and under paragraph 93(h) "any other factor that is relevant to competition in a market", which in the CBA Section's view includes efficiencies. Third, the "efficiency and adaptability of the Canadian economy" is one of the purposes of the *Competition Act* as set out in section 1.1. As noted by the Federal Court of

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4 *Canada (Commissioner of Competition) v. Superior Propane Inc.* (April 4, 2002), CT-1998/002 (Comp Trib) ("Redetermination Decision").

5 Black's Law Dictionary (5th Edition, at p. 967) defines obiter dictum as "unnecessary for the decision of the case; a remark made, or opinion expressed, by a judge, in his decision upon a cause, 'by the way', that is, incidentally or collaterally, and not directly upon the question before him, or upon a point not necessarily involved in the determination of the cause; such are not binding as precedent."

Appeal in *Canada Pipe*, "in undertaking its assessment of whether there is an actual or likely substantial preventing or lessening of competition, the Tribunal must ensure that the methodology chosen to apply the 'but for" test reflects the multiple purposes or objectives set out in section 1.1."[6] While the Court of Appeal was discussing the "but for" test under section 79 of the *Act,* presumably the same principle applies with respect to section 92. Finally, if foregone efficiencies could properly be considered in a competitive effects analysis, as suggested by the Bureau in part V of the Bulletin, it would follow that positive efficiencies should also be considered in that analysis. (As described below, the CBA Section believes that the basis for considering foregone efficiencies is unclear.)

In addition to the express statutory provisions referenced above, the fact that efficiencies are relevant to a consideration under section 93 is supported by the U.S. position on efficiencies. Section 7 of the *Clayton Act* proscribes mergers that substantially lessen competition or tend to create a monopoly, which is similar to the Canadian standard established under section 92. Part 4 of the U.S. 1997 Merger Guidelines highlight various situations where efficiencies are relevant to the assessment of whether a merger substantially lessens competition:

> Efficiencies generated through merger can enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products. For example, merger-generated efficiencies may enhance competition by permitting two ineffective (e.g., high cost) competitors to become one effective (e.g., lower cost) competitor. In a coordinated interaction context (see Section 2.1), marginal cost reductions may make coordination less likely or effective by enhancing the incentive of a maverick to lower price or by creating a new maverick firm. In a unilateral effects context (see Section 2.2), marginal cost reductions may reduce the merged firm's incentive to elevate price. Efficiencies also may result in benefits in the form of new or improved products, and efficiencies may result in benefits even when price is not immediately and directly affected. Even when efficiencies generated through merger enhance a firm's ability to compete, however, a merger may have other effects that may lessen competition and ultimately may make the merger anticompetitive.

This logic also applies under section 92. To the extent that efficiencies are likely to increase post-merger competition, they are clearly relevant to the competitive assessment and contribute at least indirectly to the evaluation of other factors. As such, the CBA Section is of the view that efficiencies should be taken into account under section 92. Furthermore, the CBA notes that in addition to the factors expressly set out in section 93, the Competition

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[6] *Canada (Commissioner of Competition) v. Canada Pipe Company Ltd*. [2006] F.C.A. 233 at para. 48.

Tribunal possesses a general discretion, inherent in the use of the word "may" in section 92(1), to decline to issue an order in respect of any merger that creates a substantial lessening or prevention of competition. In *Director of Investigation and Research v. Chrysler*[7], the Tribunal held that efficiencies were one such factor upon which the Tribunal "may" exercise its discretion in determining whether to make an order in the context of a refusal to deal case. The existence of substantial efficiencies that would contribute to post-merger competition would, in the CBA Section's view, be relevant to the Tribunal's exercise of its discretion in the merger context, and should by extension inform the Commissioner's determination of whether to make an application to the Tribunal in respect of a merger.

The CBA Section also notes that the Tribunal's comments in *Superior Propane* were made in the context of establishing that, in contrast to the integrated approach to efficiencies under the U.S. Merger Guidelines, there is no need under section 96 for efficiencies to be so great as to "cleanse" a merger of its anti-competitive effects. The comments were *obiter dicta* in this sense as they were not necessary for the Tribunal's findings in *Superior Propane*, and were not considered or reviewed by the Federal Court of Appeal.

The Commissioner stated in September 2006 that she was continuing her consultative efforts on the scope for consideration of efficiencies in the first stage of the Bureau's assessment under section 92 in light of the Tribunal's comments. This issue was also raised during the efficiencies consultations in 1995. The time it has taken for the Bureau to come to a view on the issue indicates that there are reasonable arguments on both sides. Given this and the importance of merger efficiencies under the statutory scheme, the CBA Section is of the view that the Bureau should apply the position most receptive toward efficiencies; *i.e.*, where the Bureau does not foreclose its ability to consider efficiencies under sections 92 and 93. Where efficiencies result in a situation where the merger will not harm competition or consumers, it is not necessary to then attempt to quantify anticompetitive effects in order to weigh them against the efficiencies resulting from a merger.

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[7] (1989), 27 C.P.R. (3d) 1.

Finally, a model that considers efficiencies only as a defence is inconsistent with the strong recommendation of the Advisory Panel on Efficiencies (noting that efficiencies should become a regular and explicit consideration in merger review, including at the stage of determining whether a merger substantially prevents or lessens competition).[8] It also seems consistent with the recommendations of the Competition Policy Review Panel, most notably that "the achievements of efficiencies through mergers is sufficiently important for the Canadian economy that the Bureau should review mergers with this in mind from the outset, rather than limiting its assessment of efficiency considerations to cases where it has determined that the merger is likely to prevent or lessen competition substantially".[9]

The CBA Section believes that the current framework does not preclude the Bureau from considering efficiencies when they are relevant to determining the effect of a merger on competition. The precedent for a "hybrid" approach where efficiencies provide a defence but are also potentially relevant considerations in the assessment of competitive effects exists in both the Australian and U.K. merger review frameworks.[10]

B. Balancing Weights "Approach" and Performing the Trade-off

The Bulletin states that "the Bureau will generally follow the direction given by the Competition Tribunal in *Superior Propane* by applying the balancing weights standard when considering the trade-off analysis contained in section 96". However, the Bulletin also notes that "a different approach to weighing efficiency gains against the anti-competitive effects may be appropriate in a specific case." Similar statements are made at §§ 8.25 and 8.27 of the MEGs, without any clarification or elaboration. To achieve a basic level of transparency and predictability, the CBA Section encourages the Bureau to identify the alternative approaches that may be adopted and the circumstances in which they may be applied.

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8 *Report of the Advisory Panel on Efficiencies*, *supra* note 1, at pp. 51-52.

9 *Compete to Win, supra* note 2, at p. 56.

10 *Consultation Paper on the Treatment of Efficiencies in Merger Review* (Ottawa: September 2004), at Appendix B.

As to the balancing weights standard, the CBA Section assumes that this is another name for the "socially adverse effects approach" in the MEGs. In the interests of clarity and consistency, the CBA Section suggests that the language used in the MEGs should be maintained in any policy statement made by the Bureau, whether a final version of the Bulletin or a revised version of the MEGs. The "socially adverse effects" nomenclature should be retained for the additional reason that the balancing weights concept initially introduced by Professor Townley was suggested as more of a tool to be used *within* the overall approach that is now being characterized as the "socially adverse effects approach", rather than as an approach in its own right.[11]

As recognized by the Tribunal in *Superior Propane*, the "socially adverse effects" approach may involve a number of steps, including:

- making an initial assessment of the socio-economic profiles of the merged entity's shareholders and customers (including the shareholders of business customers);
- making judgments about whether the redistributive effects of the merger likely to be identified by the Bureau, and ultimately by the Tribunal, will be considered a neutral, positive or adverse for each distinct income group of customers;
- making value judgments about the weights to be placed on such transfers;
- making judgments about the extent to which alternative uses of the product by socially advantaged groups of customers are "essential", versus non-essential;[12] and
- making judgments about the extent to which business customers may be able to pass-on any part of the wealth transfer (*i.e.*, price increase), and if so, how that is likely to impact upon their downstream customers.[13]

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[11] In short, Professor Townley's helpful insight was that members of the Tribunal often would be in a position to determine, even in the absence of complete information, whether there was any reasonable basis for believing that a weighting greater than the balancing weight ought to be applied to the socially adverse portion(s) of the wealth transfer. If not, then notwithstanding an insufficiency of the information required to accurately calculate a full set of distributional weights, it could be concluded that the efficiencies likely to result from the merger would outweigh the adverse effects on consumer surplus. See the Affidavit of Peter G.C. Townley, submitted in *Commissioner of Competition v. Superior Propane Inc. et al*., at p. 33 (available at http://www.ct-tc.gc.ca/english/CaseDetails.asp?x=68&CaseID=202#274).

[12] As discussed above, the Tribunal appears to have suggested that only expenditures for essential purposes should be included in the assessment. Redetermination Decision, *supra* note 4, at §§ 352-357 and 368.

[13] In the Redetermination Decision, *ibid*. at § 362, the Tribunal spent a significant amount of time assessing this issue but ultimately was unable to arrive at any particular conclusion given the absence of evidence on the issue adduced by the Commissioner.

In addition, a determination must be made on what weight to place on the deadweight loss, relative to the weights placed on the socially adverse portions of the wealth transfer.

Unfortunately, the Bulletin does not clarify the Bureau's approach to these steps in the analysis.

On the issue of the socio-economic profiles of the merged entity's shareholders and customers, the Bulletin simply states that the Bureau will assess the relative income levels of the consumers of the product and "producers", which is defined to mean "the owners, including shareholders, of the merged entity." This assessment will be conducted to determine whether consumers are "worse off" than producers. However, the Bulletin does not explain (i) the nature of the information that should be provided regarding the relative income levels of consumers and producers, or (ii) how that information will be assessed. The CBA Section encourages the Bureau to provide sufficient guidance on these threshold issues to enable merging parties to make the types of submissions on these issues that the Bureau expects to be made and to make a more informed independent assessment of their prospects for successfully invoking the defence in section 96. Moreover, it is at least in theory a comparison of the relative welfare of the consumers versus the shareholders or the producer which is relevant in order to determine whether the transfer is neutral. In practice, particularly with widely held corporations, this will be virtually impossible as shareholder lists change daily, as was the case in *Superior Propane*.

Regarding the critical issue of whether some (or all) of the wealth transfer will be considered neutral, positive or adverse for any particular income group of customers, the Bulletin simply states that if some (or all) consumers of the relevant product are "worse off" than the owners of the merged entity, "a portion or all of the transfer [will be] counted as part of the loss in surplus that would have to be offset by any efficiency gains that result from the merger". However, the Bulletin does not clarify (i) how much "worse off" consumers of the merged entity's product(s) will have to be, relative to the "owners" of the merged entity, before a portion of the wealth transfer will be included in the trade-off assessment, (ii) the way(s) in which the consumers need to be "worse off", or (iii) whether helpful rules of thumb (such as the "lower quintile" rule used by the Tribunal in its Redetermination

Decision)[14] will be utilized in making this decision. The CBA Section encourages the Bureau to provide additional guidance on these critical issues to enable merging parties to make their submissions to the Bureau and assess their prospects for successfully invoking section 96.

Regarding the important issue of how the Bureau will make the highly subjective determination of the extent to which alternative uses of the merged entity's product(s) are "essential", versus non-essential, the Bulletin is silent. It merely notes that "the use to which the product at issue is put" is another factor to be considered. Additional guidance on this issue would greatly assist merging parties in the ways described above.

Where some or all of the customers of the merged entity are businesses, the Bulletin states that the Bureau will consider "the relative profitability of those businesses and their ability to pass on price increases". Comparing the relative profitability of the merged entity and its business customers, and then attempting to determine the extent to which business customers may be able to pass on a price increase, is likely to be unworkably complex.[15] In the interests of achieving a minimum acceptable level of certainty and predictability, this assessment should be replaced with the general principle that any wealth transfer that may take place between the merged entity and a business customer will be weighted neutrally.[16]

If this suggestion is not embraced, the CBA Section suggests that the Bureau make it clear that such wealth transfers will be weighted neutrally unless there are clear and compelling

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14 *Ibid*. at §§ 350-351.

15 Note that courts in Canada and the U.S. have identified these difficulties in a number of class action cases involving indirect purchasers. See for example *Pro-Sys Consultants Ltd. v. Infineon Technologies AG et al*., 2008 BCSC 575 (B.C.S.C.) (on appeal), *Chadha v. Bayer Inc*., (2001), 54 O.R. (3d) 520 (Ont Div Ct.), aff'd (2003), 63 O.R. (3d) 22 (C.A.), leave to appeal to S.C.C. refused (2003), 65 O.R. (3d) xvii.

16 It is also worth noting that from a "socially adverse" perspective (as opposed to a consumer welfare standard), whether pass-through of price increases from businesses to end consumers is good or bad depends on, among other things, the relative social position of the business owners versus consumers. As such, the treatment of wealth transfers as other than neutral would not necessarily assist a challenge to a merger, since a consistent application of the socially adverse standard for wealth transfers dictates that there may be situations (e.g., a poor business owner selling to wealthy customers) where the redistributive aspects of the transaction mitigate against what could otherwise be viewed as anticompetitive effects. Neither the Bulletin nor the MEGs acknowledge this as the logical extension of weighing the relative merits of wealth transfers.

grounds for taking a different position. Some guidance should then be provided as to the types of clear and compelling grounds that may be invoked in this regard.

With respect to the issue of what weight may be placed on the deadweight loss, relative to the weights placed on the socially adverse portions of the wealth transfer, the Bulletin is again silent. Without some idea of how the Bureau will approach this aspect of the analysis, merging parties will have difficulty preparing submissions and assessing their prospects for successfully invoking the defence in section 96. Accordingly, the CBA Section encourages the Bureau to provide as much helpful guidance as possible, in an effort to promote at least a minimum acceptable level of transparency, certainty and predictability. In this regard, the CBA Section suggests that consideration be given the Tribunal's suggestion that "since efficiency concerns are paramount in merger review, perhaps adverse redistributive effects should be weighted half as much as dead weight losses."[17]

Finally, the CBA Section suggests further consideration of the temporal aspects of the efficiencies analysis and corresponding welfare implications.

C. Dynamic Efficiencies

The importance of innovation and dynamic efficiency to Canada's industrial competitiveness was discussed at length in the *Report of the Advisory Panel on Efficiencies*.[18] Following release of the Advisory Report, the Bureau commissioned an independent third party study to consider how best to assess the competitive impact of a merger on innovation and dynamic efficiency.[19] As that study indicated, a wide variety of potential dynamic efficiencies may arise from mergers.[20] First, the merger may allow for new products or processes to be introduced that would not otherwise be brought to market. Alternatively, the merger may expand the set of consumers who have access to improved products or processes, or may allow for new products or processes to be introduced to the

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17 *Superior Propane*, Redetermination Decision, *supra* note 4, at § 371.

18 *Report of the Advisory Panel on Efficiencies*, *supra* note 1, at ch. 4.

19 *Innovation and Dynamic Efficiencies in Merger Review*, Andrew Tepperman and Margaret Sanderson, CRA International, April 9, 2007.

20 *Ibid.*, at ch. 5.

market earlier than would occur but for the merger. Second, mergers may produce dynamic efficiencies that are directly related to firms' innovative efforts. These savings may include elimination of duplicative research and development (R&D), improved economies of scale or scope in R&D, improved intellectual property enforcement, and increased financial resources for R&D. To the extent that savings in innovative effort provide the merging firms with an enhanced ability to create and bring to market new or better products, services and processes, or to accelerate the time that otherwise would be required to do so, they constitute "dynamic efficiencies".

Currently, the Bulletin provides no discussion of these types of efficiencies. Instead, the Bulletin's Dynamic Efficiencies section refers to the traditional types of savings considered under section 96, such as reductions in production costs arising from an innovation in production technology. Given the limited treatment given to dynamic efficiencies in the MEGs, the CBA Section strongly encourages the Bureau to significantly elaborate on the types of dynamic efficiencies that it may consider and how those efficiencies will be incorporated into its overall analysis.

With respect to the distinction between quantitative and qualitative weightings, the Bulletin states that "[w]here possible, the assessment of dynamic efficiencies is conducted on a quantitative basis". It is not clear whether this signals a departure from the approach in the MEGs, which state that dynamic efficiencies "are generally considered from a qualitative perspective". The CBA Section encourages the Bureau to clarify this issue. In addition the Bulletin provides no guidance on how the Bureau will undertake a qualitative assessment when it is not possible to quantify dynamic efficiencies. Given the uncertainty and measurement problems associated with innovation that are described in the independent third party study, it is likely to be a rare case that allows for complete quantification of dynamic efficiencies, and the associated surplus changes associated with these efficiencies, even though these efficiencies are most likely to increase social welfare and economic

wealth.[21] This makes it all the more critical to have a meaningful discussion of the type of qualitative assessment that the Bureau would conduct when quantification is not possible. In any event, the difficulties associated with accurately quantifying likely dynamic efficiencies are such that the Bureau should generally give dynamic efficiencies a significant qualitative weighting in its analysis, particularly given the importance of dynamic efficiencies to standard of living. It would be entirely appropriate for the Bureau to adopt the position that, where a quantitative balancing of likely efficiencies against likely anti-competitive effects yields an inconclusive or "close" result and the merger is likely to result in meaningful dynamic efficiencies, the Bureau will not challenge the merger. As the third party study indicates, where dynamic efficiencies can be demonstrated, any possible price effects from a merger, if they exist, are likely to be transitory, given the competitive nature of any industry where important dynamic efficiencies are possible.[22]

The Bulletin would also provide greater guidance by discussing the type of information the Bureau has found most useful in the context of assessing the likelihood of new products or improved processes being introduced post-merger.

D. Foregone Efficiencies

It is unclear whether the efficiencies defence in section 96 contemplates including foregone efficiencies as an "effect of any prevention or lessening of competition". It is also unclear whether foregone efficiencies should be deducted from the "gains in efficiency brought about by the transaction ... that would not likely be attained if the order were made." As such, the CBA Section recommends either deleting this section of the Bulletin or a more complete legal and economic justification for the proposition that foregone efficiencies are a relevant factor in the section 96 analysis.

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[21] Joseph Brodley (1996), "Proof of Efficiencies in Mergers and Joint Ventures," 64 *Antitrust Law Journal* 575 at 581.

[22] *Ibid.*, at p. 33. An exception to the transitory nature of any possible price effects from the merger when dynamic efficiencies are demonstrated could exist if the merger allowed the parties to gain control of scarce resources that are necessary for others to innovate or if barriers to entry by other potential innovators were otherwise high.

It is not clear how foregone efficiencies can properly be considered an anticompetitive effect under section 96. Section 96 requires that gains in efficiencies be brought about that are greater than, and offset "the effects of any prevention or lessening of competition" that will, result or likely result from the merger or proposed merger. This is a key consideration. As the Court of Appeal noted in *Superior Propane*, "... the word, 'effects', should be interpreted to include all of the anti-competitive effects to which a merger found to fall within s. 92 in fact gives rise ...".[23] Effects, therefore, do not include all effects of the merger, only those of the prevention or lessening of competition to which the merger gives rise.

On this understanding, it is unclear on what basis the Bureau has presumed in the Bulletin that foregone efficiencies could be causally related to the accretion or exercise of market power by the merging parties. Indeed, it may be the case that merging parties are prepared to forego efficiencies in order to achieve other, greater, efficiencies or in order to open up new growth or business opportunities. As a result, it may not be appropriate to categorize foregone efficiencies as an effect of the prevention or lessening of competition.

The alternative approach set out in the Bulletin – deducting foregone efficiencies from efficiency gains – is also problematic. Efficiencies to be included in the trade-off analysis under section 96 are those gains in efficiency brought about by the merger that would not likely be realized if an order against the proposed merger were made. Section 96 does not appear to contemplate adjusting these efficiencies to account for efficiencies which may have been foregone by one of the merging parties. As the Tribunal noted in *Superior Propane*, "... the test to be applied is whether the efficiency gains would likely be realized in the absence of the merger."[24] Neither the Act nor the Tribunal's interpretation expressly contemplates reducing the quantum of efficiencies to reflect the fact that other efficiencies may be foregone by one of the parties.

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[23] *Canada (Commissioner of Competition) v. Superior Propane Inc.* (2001), 11 C.P.R. (4th) 289 (Fed. C.A.) at § 92, rev'g 7 C.P.R. (4th) 385 (Comp. Trib.).

[24] *See Canada (Commissioner of Competition) v. Superior Propane Inc.* (2000), 7 C.P.R. (4th) 385 at § 462 (Comp. Trib.).

There may also be evidentiary challenges for the Bureau in establishing that foregone efficiencies should be deducted from gains. In particular, there must be a high degree of certainty that any alternative plans would have proceeded but for the order. In hostile bid situations, a target may announce plans to restructure, and thereby improve operational efficiency, as a defence to the bid. Since the bid itself prompted the restructuring plans, it may be inaccurate to state that the efficiency gains that would result from implementation of the restructuring plans have been "foregone" if the bid is successful.

Finally, there may be double counting if foregone efficiencies are treated both as an anti-competitive effect and as a deduction from the efficiency gains generated by a merger.

If the concept of foregone efficiencies is retained, the Bulletin should deal with the concept more thoroughly with a view to addressing the uncertainties outlined above.

E. Treatment of International Mergers

The Bulletin does not sufficiently acknowledge the complexities associated with determining whether efficiencies in certain international mergers accrue to the Canadian economy. For example, if a transborder merger could lead to the closure of a plant in Canada or the U.S., the question arises as to which closure would be preferable under section 96 if the Canadian closure would reduce overall costs incurred in Canada, but the U.S. closure would result in lower per unit operating costs.

F. Role of Efficiencies in a Coordinated Effects Case

The Bulletin makes no mention of how efficiencies will be considered in a coordinated effects case, one of the two types of anticompetitive merger scenarios postulated in the MEGs. In particular, the MEGs indicate that a merger may result in anticompetitive coordinated effects if it is more likely to create the conditions to facilitate coordinated behaviour. Such coordination can be a function of many "facilitating factors", including the degree of product homogeneity and cost symmetries among firms. The MEGs recognize that coordination is easier when firms have similar cost structures and, conversely, more

difficult when they have different cost structures.[25] Thus, the impact of efficiencies on the merged entity's cost structure may be relevant to determining whether a merger is likely to harm competition and product anticompetitive effects. This is expressly recognized in the U.S. Horizontal Merger Guidelines, which state that in a coordinated interaction context, "marginal cost reductions may make coordination less likely or effective by enhancing the incentive of a maverick to lower price or by creating a new maverick firm".[26]

The CBA Section believes that excluding efficiencies from the section 92 analysis of whether competition is likely to be prevented or lessened substantially is problematic in a coordinated effects case, since cost savings can be directly integral to a proper assessment of firms' incentives to compete. If the Bureau insists on confining the role of efficiencies in a coordinated effects case to section 96, the CBA Section recommends that the Bulletin make clear that efficiencies will be relevant not only to the "gains in efficiency" side of the equation, but also to the determination of "the effects of any prevention or lessening of competition".

G. Absence of Guidance on Section 96(2)

Because the MEGs offer limited guidance in relation to section 96(2),[27] it would be helpful if additional guidance were provided (in the Bulletin or, preferably, in the MEGs) in relation to section 96(2).

Section 8.10 of the MEGs states that in order"[t]o assist this [section 96(2)] analysis, firms operating in markets that involve international trade should provide the Bureau with information which establishes that the merger will lead them to increase output due to greater exports or import substitution." Footnote 97 goes on to state that "[i]ncreased output in this context is generally only possible with an associated decrease in price."

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[25] MEGs, at Part 5.22.

[26] U.S. Department of Justice & Federal Trade Commission, Horizontal Merger Guidelines (1992), at s. 4 (revised April 8, 1997).

[27] Section 96(2) provides that "[i]n considering whether a merger or proposed merger is likely to bring about gains in efficiency described in subsection (1), the Tribunal shall consider whether such gains will result in (a) a significant increase in the real value of exports; or (b) a significant substitution of domestic products for imported products".

It would be helpful if the Bureau were to indicate how it goes about assessing the impact of increases in exports and import displacement in the trade-off analysis. Is it relevant only if the trade-off is otherwise close? Is it intended to supplement efficiencies otherwise recognized? Where section 96(1) requires a quantitative or at least qualitative comparison, section 96(2) does not appear to do so. It only requires *consideration* of increases in exports or displacement of imports. How does the Bureau accomplish this *consideration*? Also, what interpretation is to be given to the term "significant"?

In addition to addressing these items, it would be sensible to include a variant of the statement in Part 5 of the 1991 MEGs respecting section 96(2); *i.e.*, "[t]he words 'described in subsection (1) [of section 96]' make it clear that section 96(2) does not operate to expand the class of efficiency gains that may be considered in the trade-off analysis. Accordingly, this provision is simply considered to draw attention to the fact that, in calculating the merged entity's total output for the purpose of arriving at the sum of unit and other savings brought about by the merger, the output that will likely displace imports, and any increased output that is sold abroad, must be taken into account." In this regard, the CBA Section suggests that the Bureau depart from the statement in the 1991 MEGs to the effect that consideration of section 96(2) will focus on output expansion related to lower prices.[28] One can imagine a merger where output is relatively constant but the value of exports increases due to price increases. In this scenario, if the majority of sales are outside Canada (which is by no means unusual), then the anticompetitive effects in Canada may be small relative to the increase in the value of exports.

Finally, the Bulletin states that "[t]he language of section 1.1 and section 96(2) provides some guidance on what consideration should be given to gains in efficiency that are likely to be achieved outside Canada." It is not evident that section 96(2) addresses efficiencies likely to be achieved outside Canada. Indeed, it would seem likely that efficiencies achieved in Canada are more likely than those achieved outside Canada to result in increased exports and replacement of imports by domestic products.

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[28] 1991 MEGs, at Appendix 2.

H. Other

Fixed and variable costs - The Bulletin (at p. 3) states that parties should indicate whether cost savings "result from fixed or variable (marginal) costs". It would assist for the Bureau to explain how this distinction will be employed in practice. Efficiencies need not impact marginal costs, unlike in the U.S. and other jurisdictions, to count under section 96. That said, the CBA Section encourages the Bureau to recognize that reduced marginal costs may mitigate the possibility of harm to competition. Nonetheless, the CBA Section believes that the Bulletin would benefit from a clear affirmation that all cost savings, whether variable or fixed, will be taken into account under section 96.

Evidentiary matters and hostile bids - The discussion of the evidence needed to prove an efficiencies case in Part II of the Bulletin seems to set the evidentiary bar higher for parties seeking to make out an efficiencies defence than the Commissioner is held to in establishing that a merger substantially prevents or lessens competition. The Bulletin states that access to certain categories of information is "required". While the CBA Section recognizes the utility of obtaining the types of evidence outlined, such evidence may not always be available, and that it should not therefore be "required". This is particularly true in the case of a hostile takeover bid, where the bidder may not have access to non-public information respecting its target, and will be forced to build its efficiencies case based on assumptions about the target's business. The language in Part II of the Bulletin should be toned down to indicate that the categories of information are not mandatory, and to provide guidance on the development of efficiencies submissions in the context of hostile bids in particular.

IV. CONCLUSION

The CBA Section thanks the Bureau for the opportunity to submit these comments, and commends the Bureau on its ongoing efforts to clarify its approach to efficiencies in merger review. The CBA Section would be pleased to discuss these comments with the Bureau in greater detail.