Superior Propane: the case that broke the law

Canada's experience with efficiencies offers valuable lessons to other jurisdictions, writes ***William Rosenfeld***, head of competition at Goodmans LLP, Toronto

The Competition Act of Canada contains a unique provision. Section 96(1) of the Act elevates efficiencies derived from a merger to the point that, if gains in efficiency "will be greater than, and will offset, the effects of any prevention or lessening of competition that will result", then the merger must be allowed. The Canadian experience in elevating efficiencies to a level which outranks anti-competitiveness has been confused, costly, and proven ultimately unacceptable. If the Canadian experience is to be taken as an example, those who would make efficiency the ultimate objective of a competition law regime would be wise to be warned.

The distinctive treatment of efficiencies was introduced in Canada in 1986, which saw a dramatic transformation of Canadian merger law. Where previously an ineffectual criminal sanction existed to constrain "combines," a new coherent regime of administrative review and civil law constraint was introduced. Since 1986 merger review has become an integral part of Canadian economic activity with procedures parallel to, but certainly not identical with, those of both the United States and the European Union.

The 1986 legislation followed several parliamentary initiatives in which successive bills had been introduced but not enacted into law. Throughout the consideration of those bills, and specifically of Bill C-95, which became the Competition Act, the role of efficiencies in merger review was prominent.

Supporting the debate lay the implicit assumption that, in order to survive, Canada needed disproportionately large enterprises to take on the larger world. Fostering efficiency therefore, was the way to achieve policy objectives. Canada has always been an economy dramatically dependent upon exports. The geographic extent and the small population of the nation itself has historically led to a concentrated industrial structure. The ability to maintain large capitally intensive enterprises in Canada's essential mining, oil and gas, and forest industries has constantly focused competition law upon the need to foster efficiency. The debate behind the Competition Act does clarify the perspective. In the Report of the Economic Council of Canada in 1969 it was boldly stated that "competition policy should aim primarily at bringing about more efficient performance by the economy as a whole. Competition should not itself be the objective but rather the most important single means by which efficiency is achieved." The provisions of the four bills introduced from 1971 to 1983 prior to Bill C-91, which finally became the Competition Act, all gave prominence to efficiencies. Bill C-913 played the trump card: efficiencies could overrule anti-competitive effects. Not surprisingly the Committee consideration of Bill C-91 contains clear statements of government intent: "Competition itself is not an end, but is rather the most effective means of stimulating efficiency and productivity and Canadian industrial growth … we have to be cognizant of efficiency, international competitiveness and fairness."

It follows that in contrast with the anti-trust law of the United States, in Canada the importance of protecting consumers and small businesses has assumed less importance. In *Superior Propane*, the Competition Tribunal, the quasi-judicial body ultimately responsible for passing upon mergers, has remarked that "Parliament clearly understood that consumer protection was not the main goal of the merger provisions or of the Act." Equally, while there has been significant debate on the issue, the Competition Tribunal has stated that, excepting narrow circumstances, "there would be no basis for the Tribunal to consider the small-business implications at all" in merger review.

But if the Competition Act made it clear that efficiencies were to be of great importance, the Act shed no light on the manner in which those efficiencies were to be calculated. The Competition Bureau, responsible for the administration of the Act, took upon itself the task of articulating, for administrative purposes, the view of efficiencies which it would take in reviewing merger applications. The task was not lightly assumed, and there was extensive debate within the Competition Bureau, leading up to the promulgation of Merger Enforcement Guidelines in 1991, five years after the passage of the Act. In the close attention paid to the efficiency exception in the MEGs it was clearly stated that: "When a balancing of the anticompetitive effects and the efficiency gains likely to result from a merger demonstrates that the Canadian economy as a whole would benefit from the merger, s.96(1) explicitly resolves the conflict between the competition and efficiency goals in favour of efficiency."

For the Bureau, after recognising the supremacy of efficiency, lay the extremely important question of measuring those efficiencies, and weighing them against the "effects" of an anti-competitive merger. Here the important question is whether efficiencies which may result in increased prices to consumers are to be seen as negative and hence deducted from the efficiencies produced by the merger (the "consumer price standard"), or whether the redistributive effect of efficiencies is to be ignored, and a "total surplus standard" adopted. In the latter case, an efficiency which redounded to the benefit of a shareholder would be given equal weight with a benefit enjoyed by a consumer. Under the total surplus standard it is the effect of the efficiency upon the economy as a whole which matters, not the impact upon any particular element in society. The MEGs resolved this question unequivocally in favour of the total surplus standard. The MEGs state quite simply that "when a dollar is transferred from a buyer to a seller, it cannot be determined a priori who is more deserving, or in whose hands it has greater value." The die was cast.

Following the promulgation of the MEGS, the Competition Bureau further committed itself to the total surplus standard. In 1992, Reed J in the *Hillsdown* case questioned whether wealth transfer was truly neutral, thus questioning whether the total surplus standard was correct. But her doubt was not central to the determination of the case, and subsequently, the then Director of the Competition Bureau confirmed that the Bureau would continue to take the position on efficiencies articulated in the MEGs. He further stated that the MEGs would not be revised. Judicial reservations on

the total surplus standard were thus explicitly rejected by the Competition Bureau.

It is against this backdrop that the case of *Superior Propane* dramatically appeared upon the stage. Prior to *Superior Propane* the Competition Bureau had never concluded a merger review by deciding that efficiency gains were of such magnitude that efficiencies offset any substantial lessening of competition. In the course of merger reviews, the Competition Bureau certainly expressed interest in merger-specific efficiencies, but never appeared to regard them as decisive factors. And, not surprisingly, there had been no instance in which the Competition Bureau had sanctioned a merger to monopoly. The Competition Tribunal had considered the question of efficiencies only twice, and then only in passing. It is really questionable whether, in any scenario, a merger to monopoly, relying upon the efficiency defence, had seriously been contemplated by the Competition Bureau. *Superior Propane* appears to have been a real surprise. In the result, the Bureau reacted strongly and resisted the *Superior Propane* merger in a most vigorous, but ultimately unsuccessful litigious battle.

Concepts which are entirely valid in economic analysis must be presented to the Competition Tribunal and to courts. But the concepts themselves are frequently difficult to communicate and the evidence required to demonstrate the application of those concepts little short of overwhelming

In December, 1998 Superior Propane Inc acquired ICG Propane Inc and the Commissioner of Competition immediately filed an application before the Competition Tribunal seeking an order to dissolve the merger. At the initial hearing the Competition Tribunal found that the merger was likely to lessen competition substantially in many markets but that pursuant to Section 96, the merger was likely to bring about gains in efficiency that would be greater than and would offset the effect of that substantial lessening of competition. The Commissioner appealed. The Federal Court of Appeal in April, 2001 remitted the matter to the Tribunal, which again, in April, 2002 reached essentially the same determination as it had earlier. The Commissioner appealed again and the Court of Appeal in January, 2003 confirmed the second judgment of the Competition Tribunal. In the result it was held that the anti-competitive merger succeeded because the efficiencies which it had produced were greater than, and offset, the anti-competitive effects of the merger. Four judgments containing 255 pages of reasoning, spread over three years, produced a finding on efficiencies which confounded many observers.

The grounds for the confusion are not difficult to identify. In its initial judgment the Competition Tribunal found several local areas where the concentration resulting from the merger produced a virtual monopoly. In the Canadian landscape these areas are readily identifiable, relatively sparsely populated, and unlikely to experience economic development which would modify the monopolistic conclusion. It would therefore be presumed that the price increase for consumers in these areas would be considerable and would endure. But the Competition Tribunal, in its extensive and articulate judgment, focused upon efficiencies under the total surplus standard, which ignored any redistributive effect from consumers to producers. The numerical result therefore, was that while annual efficiencies were held to be C$29.2 million per year, the annual dead weight loss was held not to exceed C$6 million. Because any wealth transfer from consumers to producers was disregarded, on the total surplus standard the resulting calculation yielded the conclusion that the merger would bring about gains in efficiency that were greater than, and offset the effects of any lessening of competition. The Competition Bureau, not surprisingly, had difficulty in arguing for a balancing weight standard between producers and consumers with respect to efficiencies when its own guidelines had spoken to the total surplus standard as appropriate.

Nonetheless, on appeal to the Federal Court of Appeal, the Commissioner was partially successful in arguing that the "balancing weights" standard ought properly to be adopted and that the interests of consumers should be more closely examined. By accepting a standard other than the total surplus standard, the Court of Appeal at least released the Commissioner from the self-imposed constraint of the MEGs.

The Court's consideration was wide-ranging. It reviewed the US position on consumer welfare and reviewed the general position of efficiencies under Canadian legislation. The Court did not agree with the Initial Tribunal Judgment that efficiency was the overriding concern of Canadian law. The Court looked, as well, to the purposes of the Act. It returned the case to the Competition Tribunal for re-determination on the basis that the total surplus standard was not appropriate in all cases but that the correct methodology for the determination of the extent of the anti-competitive effects of a merger should be left to the Tribunal. The Court was quite emphatic in questioning the reasoning of the Competition Tribunal, stating that "the effects of a lessening of competition suggests a more judgmental assessment of deadweight loss than is called for by the largely quantitative calculation of deadweight loss that the Tribunal adopted."

Nor was the Court of Appeal impressed with the argument that the total surplus standard provides greater predictability than more qualitative standards. And in attempting to hack its way through the thicket, the Court of Appeal had no difficulty in articulating clearly that the MEGs were not the law and that the Act did not encapsulate the total surplus standard in the efficiency defence of Section 96.

The Court also examined a perennial Canadian concern: how was one to deal with efficiency gains made for the benefit of foreign corporations to the detriment of Canadian workers and consumers? Reluctantly, the Court concluded that the statute provided no guidance, but it was clear that Section 96 "was not meant to authorise the creation of monopolies since it would defeat" the general purposes of the Act.

The case then went back to the Competition Tribunal which, most surprisingly and to the Commissioner's dismay, found at least 10 instances where it disagreed with the Court of Appeal. It would be difficult to find a similar instance in Canadian jurisprudence where so little deference was given to the pronouncements of an appellate court.

Where the Court had stated that the Competition Tribunal "is charged with the responsibility of protecting the public interest", the Competition Tribunal concluded that its mandate was not to make decisions driven by "public interest concerns". While the Court had stated that the effects to be considered under Section 96 should include regard for medium and small businesses and consumer interests the Tribunal replied that "there is no policy choice to favour consumer" concerns and "efficiency was the paramount objective of the merger provisions of the Act".

When the Court took note of the

Horizontal Merger Guidelines promulgated by the US Federal Trade Commission with some approval, the Tribunal noted somewhat fractiously that: "[T]he adoption of the American approach to efficiencies under the Act would, without question, introduce the hostility that characterises that approach. As noted above, the amendments in 1986…were primarily focused on economic efficiency."

In a particularly graphic manner, the Court of Appeal had suggested that the Tribunal had "ignored as an effect of the merger the fact that monopolies in certain product markets would ensue and failed to give any weight to that effect in its analysis under S.96… S.96 was not meant to authorise the creation of monopolies since it would defeat the purpose of" the statute. But the Competition Tribunal had no difficulty in stating that if the Court of Appeal "is suggesting the efficiency defence should not be available when mergers lead to a structure of monopoly then, with respect (the Court of Appeal) must be wrong".

In one important particular, however, the Second Tribunal Judgment did follow the direction of the Court of Appeal. The Competition Tribunal sought to apply the "balancing weights standard" on the effects of any lessening of competition and it concluded that the evidence tended to support the "socially redistributive effects regarding low income households that use propane for essential purposes" but that the numerical impact was small. The Competition Tribunal does not make it clear why business, such as farming enterprises, should be weighted equally with shareholders of the merged firm. But the Competition Tribunal does place a hugely onerous burden on the Commissioner to present a precise socio-economic profile on consumers and shareholders of producers in order to measure the impact of socially adverse redistributive effects.

In the result, the Competition Tribunal concluded that the "balancing weights standard" did not modify the conclusion of its initial judgment that efficiencies were to prevail to offset the effects of any substantial lessening of Competition. The merger was not to be constrained.

After having been castigated by the lower body, it is certainly surprising that in its further, and second judgment, the Federal Court of Appeal concluded "prima facie the Tribunal has followed the directions of the Court." Since the Tribunal was characterised by the Court as having acted well within the discretion conferred upon it in applying the balancing weights standard, the subjective arithmetic conclusion of the Tribunal was accepted and the appeal from the Commissioner dismissed. Merger to monopoly prevailed.

In a dissenting opinion, Létourneau JA stated emphatically that: "I remain convinced that the creation of monopolies is the ultimate adverse, anti-competitive effect which defeats the very purpose of the Act as expressed in S.1.1. In the name of economic efficiency the Act allows for a substantial lessening of competition, but it does not authorise its elimination altogether. …Parliament intended and the Act reflects that intent…."

The impact of the second hearing before the Court of Appeal did, at least, bring an end to the litigation. Prominent economists pointed out that the original Competition Tribunal judgment was based on flawed data, and that had the computation of deadweight loss been properly effected in that initial hearing, then the deadweight loss would not have been C$3.0 million but would have been C$25.5 million. Consequently the Tribunal might well have reached a contrary conclusion had it considered the correct evidence.

The prevailing view among economists probably remains that the total surplus standard, perhaps as slightly modified by the Second Tribunal Judgment, is the correct benchmark. Therein perhaps lies one of the profound issues in *Superior Propane*, and in competition law generally. Concepts which are entirely valid in economic analysis must be presented to the Competition Tribunal and to courts. But the concepts themselves are frequently difficult to communicate and the evidence required to demonstrate the application of those concepts little short of overwhelming. In *Superior Propane* the result has been to create confusion among many based, at least in part, upon a failure to apply correct mathematics to the economic models involved.

It is not, therefore, surprising that the Commissioner determined that further appeal from the Second Court of Appeal Judgment was not useful. He advised the Standing Committee on Industry, Science and Technology of the House of Commons that "further litigation would not have clarified the efficiency defence. Only a legislative solution is workable."

His comments were addressed to Private Member Bill C-249, introduced into the House of Commons, and passed by that body, now (October 2003) before the Senate for consideration.

Bill C-249 appears, in many respects, to be a clear answer to the Second Tribunal Judgment. In her dissent in that judgment, Tribunal Member Ms Lloyd had expressed particular concern "with the tremendous number of estimates that were provided as inputs into the calculations that formed part of the extensive economic evidence presented in relation to the efficiencies defence. For example, the input required to establish deadweight loss and transfer estimate included compounded estimates of volume, prices per litre by end-use and projected price increases by end-use. This is not to say that using some arithmetic standard is not necessary; however, in my view such a standard should be used as a tool/guide in reaching a decision and should not be interpreted as having such precision so as to be concluded as being an end in itself. Qualitative input is, in my view, imperative in analyzing the effects of an anti-competitive merger."

Bill C-249 would replace Section 96(1) in its entirety and thereby remove the efficiency defence from the Act. In its place, the Bill would provide that the Tribunal, in determining whether a given merger was likely to prevent or lessen competition substantially: "…may, together with the factors that may be considered by the Tribunal under S.93, have regard whether the merger or proposed merger has brought about or is likely to bring about gains in efficiency that will provide benefits to consumers…. that would not likely be attained in the absence of the merger or proposed merger."

Bill C-249 is a pointed reaction to the tortuous result achieved in *Superior Propane*. It swings from total surplus standard to something close to the US view on efficiencies expressed in the Horizontal Merger Guidelines. There it is stated that "… efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great. Efficiencies almost never justify a merger to monopoly or near-monopoly."

Bill C-249 has been introduced as an antidote to *Superior Propane*. The Tribunal under Bill C-249 can consider efficiency gains and also take into account the impact upon consumers, without attempting to constrain itself with specific formulae. The change is to be welcomed, significantly because it moves away from the unmanageable complexity of weighing efficiency against substantial lessening of competition.

The history of *Superior Propane* has been long, convoluted and unfortunately unclear. The debate on the appropriate surplus standard will no doubt continue, regardless of the fate of Bill C-249. And, in future, it will be a very brave merger proponent who will seek to rely upon efficiencies to save an anti-competitive merger in Canada. *Superior Propane*, at huge expense, probably got the last stage coach out of town.