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Competition Act Consultations
c/o PRIME Strategies/Intersol
#205-240 Catherine Street
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Dear Sirs:

Re: Treatment of Efficiencies under the *Competition Act* (the "Act")

We are writing in reference to your invitation to submit comments with respect to the consultation paper on the treatment of efficiencies under the Act.

The role of efficiencies in merger review and, in particular, the interpretation of the efficiency defence following the *Superior Propane* case, has been hotly debated over the past several years. This consultation broadens the debate by considering the application of efficiencies to other provisions of the Act.

We believe that much of the disagreement is driven by different interpretations of the purpose of the Act. This consultation provides an opportunity to reconsider the primary purpose of the Act and whether or not the purpose clause accurately reflects the will of Parliament.

Opposing Views of the Purpose of the Act

Many economists would say that preserving competition is a means to the ultimate goal of economic efficiency. Prices are important only as a signalling mechanism to ensure the efficient allocation of resources. The harm of anti-competitive activity is measured by the reduction in allocative efficiency (the "deadweight loss") created by reduced output. Under the total surplus approach, income transfers between producers and consumers due to higher prices are ignored. Under the balancing weights approach, as implemented by the Competition Tribunal, the socially adverse portion of the income transfer is somehow measured and added to the deadweight loss and traded off against the gains in productive efficiency. In either approach, dynamic efficiencies are essentially ignored because they cannot be predicted or measured.

Many non-economists would say that the ultimate or paramount goal of the Act is to preserve competition to ensure consumers have competitive prices and product choices. They believe that competition would spur both allocative and dynamic efficiencies. In the great majority of cases, they believe there is no tradeoff to make, and where there is, it should be decided in favour of consumers.

The answer to this fundmental question about the purpose of the Act drives the policy choices in this consultation. There was much discussion by the Competition Tribunal and the Federal Court of Appeal in *Superior Propane* about what Parliament intended when it drafted the purpose clause and section 96. Legislative action to change the approach to efficiencies in merger review would provide an opportunity for Parliament to reconsider the purpose clause and decide whether or not all of the objectives are to be equally weighted or whether there is a primary objective of the Act.

Merger Provisions

Status Quo

If Parliament believes that economic efficiency is the paramount objective of the Act, it should retain the current defence or strengthen it to make it clear that the total surplus standard is the standard to be applied. In our view, the *Superior Propane* case has essentially put in place a modified total surplus standard. The Competition Bureau will rarely be able to prove the socially adverse portion of the income transfer between producers and consumers. In most cases, small gains in efficiencies will trump the measured deadweight losses. Anti-competitive mergers with modest efficiencies will pass this standard, unless there is significant pre-existing market power.

Supporters of the *status quo* cite the need to allow anti-competitive mergers, even at the expense of competition, if it enhances economic efficiency. Two points are worth noting:

- First, the efficiency defence has been applied only once in over 4,000 mergers reviewed since 1986. It has rarely played a role in the decisions of the Competition Bureau. Where it has carried some weight has been in cases where there were borderline competition problems and where efficiencies were significant. It clearly has not worked in the way the supporters of the defence intended.

- Second, Canada has had a much more permissive approach to mergers than the United States. By setting a higher tolerance for domestic concentration and greater reliance on import competition, the Competition Bureau has provided scope for efficiency–enhancing mergers as a matter of practice, without the need for an explicit defence.

Section 93 Factor Approach

If Parliament intends that consumer welfare be the paramount objective of the Act, it should elminate the efficiency defence. It could include efficiency as a factor to be considered in section 93. Efficiencies could also be considered as a relevant factor under paragraph 93(h). The choice of making it an explicit factor is one more of emphasis than actual effect.

In the factor approach, there is no tradeoff or balancing required. The issue is whether or not the merger substantially lessens or prevents competition ("SLPC"). Since efficiency gains drive costs lower, there is an incentive to reduce prices in order to increase output and maximize profits. This factor works in opposition to the incentive to increase price resulting from a reduction of

competition that flows from an anti-competitive merger. Anti-competitive mergers with significant efficiency gains may be predicted to produce no increase in price or only a modest increase in price. Under the current law, a merger does not create a SLPC if the parties acquire an ability to raise price, as long as they cannot raise price to a level considered substantial.

Under the factor approach, there is no need to include a requirement that efficiencies be passed on to consumers. In order for an otherwise anti-competitive merger to pass the SLPC test, efficiency gains must be passed on to consumers. If they were not, prices would remain above the SLPC standard.

The above discussion relates to prices and price increases since these can be measured and estimated using modern econometric techniques. The discussion would also apply to non-price anti-competitive effects and efficiency benefits, such as product choice and quality. In practical terms, these cannot usually be measured and the analysis is a qualitative assessment.

The movement away from a defence to a factor may have one important procedural advantage. Merger parties may feel more inclined to make efficiency claims as part of the regular merger review process since they are not raising a "defence" to an otherwise anti-competitive merger. Similarly, the Competition Bureau may be more inclined to receive and accept these arguments since the stakes are lower. It would be one of many factors to consider, not a trump card to an otherwise anti-competitive merger.

It is important to note that the Competition Tribunal reviews very few mergers. Almost all of the merger review activity occurs at the Competition Bureau. A legislative change that makes it more likely that the analysis of efficiencies will become a normal part of the Bureau's review will assist merger proponents who have legitimate efficiency claims to make but who are unwilling to bear the high costs and delays of litigation.

Efficiency considerations should be examined whenever they are relevant. There is no need to make such examination mandatory. They should be considered over any period in which they can be verified or predicted with reasonable confidence. There is no need to require them to be achieved in two or three years. Gains that are predicted to occur in the more distant future will carry greater uncertainty and should be accorded less weight. Savings in fixed costs should be included.

The factor approach would be consistent with the competition law treatment by our major trading partners, the United States and Europe. Only Canada and South Africa have an efficiency defence to anti-competitive mergers.

For the reasons noted above, we believe that a factor approach is preferable to the *status quo*.

Merger to Monopoly Exception

The consultation paper discusses a merger to monopoly exception or limitation to the existing efficiency defence. Under a total surplus approach, there is no justification for such an exception. If a monopoly were the most efficient industry structure, it would maximize total surplus to have one producer. In this case, economic regulation of the monopolist would be an alternative means to achieve non-efficiency objectives.

Under a consumer welfare approach to section 96 or a factor approach under section 93, it is very unlikely that a monopoly or near monopoly would produce enough gains in efficiencies that would prevent a SLPC and such an exception would not be required.

Merger Outcomes

The consultation paper raises the option of amending section 96 to give the Competition Tribunal the power to reverse an earlier decision to allow an anti-competitive merger to proceed on the basis of the efficiency defence. This power would be available if the predicted efficiency claims on which the decision was based have fallen short of expectations.

The consultation paper does not specify a time period in which this re-opening could take place. Section 97 only limits the Commissioner from filing an application more than three years after a merger has been substantially completed. If no timeframe is established, merging parties could be at risk of having their merger undone many years after the Competition Tribunal's final decision, which itself may have occurred a number of years after the merger was initially proposed. Similarly, the Competition Bureau would have to expend resources on monitoring efficiencies over this period.

Over such a long period, many other factors may have changed in the markets under review such that the merger may no longer create a SLPC. However, in this re-opening exercise, only the actual efficiencies would be considered. Should not the actual efficiencies gains be balanced against the observed anti-competitive effects?

Under the current regime, litigation can be protracted, but there is an end to the process. In merger analysis, judgements about the future have to be made on the evidence available at the time the decision is made. Some of these judgements and predictions will turn out to be wrong. However, there is merit in having finality in litigation. Uncertainty has a cost to the economy that must be weighed against the benefits of getting it right in a particular case. An open-ended power to revist the efficiency issue many years after the merger is proposed or completed creates considerable uncertainty.

This option does not resolve the fundamental debate over the appropriate welfare standard to be applied. It targets only one of the problems with the *status quo*, the uncertainty of the predicted efficiencies. We would not recommend this option.

Efficiencies in Other Provisions of the Act

If a new civil strategic alliance provision were enacted, it would make sense to make the treatment of efficiencies consistent with the merger provisions since the analytical framework is essentially the same. For the reasons noted above, we believe that a factor approach is preferable to an efficiency defence.

As the consultation paper noted, the specialization agreement provisions have not been used since their introduction in 1986. If a provision has had a long history of inaction, it suggests that it is either serving no useful purpose and can be eliminated without causing harm, or is flawed as drafted and is not achieving its original objectives. The Bureau may want to consult on the reasons why this provision has not been used and take action accordingly.

The consultation paper does not raise the issue of how efficiencies are treated in the many other provisions in the Act. Should efficiencies be explicitly considered as a factor in abuse of dominance, tied selling, exclusive dealing, market restriction and price maintenance? These provisions implictly contain efficiency notions in the concepts of superior competitive performance, legitimate business justification and in the defences of section 61. If efficiencies are to be included as a factor in these provisions, on what basis should they be evaluated and is there any reason why the standard would be different than that used for merger review?

Conclusion

The policy choices in this consultation depend to a large extent on how one views the objectives of the Act. Parliament may want to reconsider the purpose clause as well as the specific initiatives discussed in the consultation to ensure they are consistent. If consumer welfare is paramount, then the efficiency defence in merger review should be eliminated. Efficiences should be retained as a factor or implicit factor in the determination of the substantial lessening or prevention of competition.

Yours very truly,

GOODMANS LLP

Per:

Richard Annan

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