

## EFFICIENCIES STANDARDS: TAKE YOUR PICK

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### Introduction

The question posed for a session at a recent conference on competition policy was whether the merger review process has become dysfunctional. This is a strong term. It implies that something more is needed than routine procedural reforms. Presumably, it was the decision of the Federal Court of Appeal<sup>2</sup> in the appeal of the Competition Tribunal's initial decision in *Superior Propane*<sup>3</sup> that led the planners of the conference to pose the question in these terms. The issue is presumably whether the lack of statutory clarity with respect to section 96 of the *Competition Act* together with the jurisprudence with which it has now been burdened make the merger provisions of the Act unworkable in the sense that the evidentiary requirements are too great, the proceedings are too complex and the likely outcomes too idiosyncratic. To some, there is a need for a review of section 96, to others there is a need to amend it.

The situation is certainly not a pretty one but there are some indications in the decision of the Competition Tribunal in the *Superior Propane* redetermination that there may be light at the end of the tunnel.<sup>4</sup> There is plenty of bad news but perhaps also some good news. The bad news is, first, that to comply with a poorly-reasoned decision of the Federal Court of Appeal, the Tribunal has adopted a balancing weights interpretation of section 96. This approach will not be workable and, indeed, is no longer advocated by the Commissioner of Competition who was its sole champion. Second, the Tribunal and the Commissioner remain seriously at odds with respect to the interpretation of section 96. The Commissioner has moved on to advocate a consumer surplus interpretation of section 96. This is the Commissioner's third interpretation of section 96 in three years. The consumer surplus interpretation of section 96 has little to commend it. Criticisms of it by the Commissioner's own expert witness in *Superior Propane*, Professor Townley, are cited at some length by the Tribunal in the Redetermination Decision.

The good news is that the total surplus interpretation of section 96 which had come to be the Tribunal's preferred interpretation may yet survive as the default standard where evidence of adverse redistributive effects or the weight to be attached to them is inconclusive. The Redetermination Decision leaves the clear impression that, in the absence of persuasive evidence to the contrary, the Tribunal will assume that income transfers are neutral. The assumption that redistributive effects are neutral is the essence of the total surplus standard. The implication is that the Tribunal may ultimately be able to comply with the Appeal Judgment without changing the fundamentals of merger review. If this turns out to be the case, it would be a welcome outcome. While there are issues to resolve, there is nothing fundamentally wrong with the way section 96 was interpreted by the Competition Bureau for 15 years. As the Tribunal makes clear in the Redetermination Decision, the argument that a total surplus interpretation of section 96 allows a successful efficiencies defence for any merger, no matter how anti-competitive, is simply incorrect. There was and is no persuasive case to be made for abandoning the total surplus standard on the grounds that it constitutes a free pass to monopoly or dominance.

Of course, the Commissioner may have other ideas. He is also appealing the Redetermination Decision. While it is difficult to imagine an appellate court directing the Tribunal to adopt a consumer surplus standard, stranger things have already happened. Amendments to section 96 have also been proposed in Bill C-248.<sup>5</sup> As written, Bill C-248 would limit the situations in which section 96 could be applied, restrict the type of efficiencies that could be considered under section 96 and, possibly, change its interpretation yet again.

### **Efficiencies Standards: What's Hot, What's Hot**

The Tribunal examined five possible interpretations of the efficiencies defence in the Redetermination Decision. Of these, four can be considered “in play.”

The first interpretation considered is what the Tribunal calls the “pure price standard” [86]. The pure price standard requires prices to fall post-merger by the full amount of the efficiency gains. Put another way, prices must fall post-merger by the same percentage as unit costs. This can only occur if the merger does not increase market power in the first place. For this reason, Robert Pitofsky calls the full pass-on requirement “a killer qualification.”<sup>6</sup> Bill C-248 contains a pass-on requirement that could be interpreted in this way.

The second interpretation of the efficiencies defence considered by the Tribunal is what it calls the modified price standard [87]. This is generally known simply as the price standard. It requires efficiency gains to be large enough to keep the price from rising post-merger. The price standard says that consumers (as consumers) cannot lose from a merger. The United States appears to use a price standard although the Tribunal suggests that it could also be interpreted as using the consumer surplus standard. As will be illustrated below, the price standard is extremely difficult to satisfy and there has been no suggestion from the Commissioner or from others that it is the appropriate interpretation of section 96.

The third possible interpretation of section 96 is the consumer surplus standard. The consumer surplus standard requires that the value of the efficiency gains resulting from the merger exceed the loss (deadweight loss plus transfer) in consumer surplus. It treats a dollar transferred from a consumer to a producer as a dollar lost by the economy regardless of the wealth of the consumer or the wealth of the producer. The consumer surplus standard was suggested by the Competition Tribunal in an *obiter dictum* in its 1992 *Hillsdown* decision.<sup>7</sup> The Commissioner argued in favour of a consumer surplus standard in the *Superior Propane* redetermination and his arguments were rejected by the Tribunal [334]. Presumably, the Commissioner will argue in his appeal that the Tribunal erred in law when it rejected the consumer surplus interpretation of section 96.

The fourth possible interpretation of the efficiencies defence considered by the Tribunal is the total surplus standard. The total surplus standard requires that the economy as a whole must gain from the merger. This requires, in turn, that producer gains exceed any consumer losses. The total surplus standard assumes that transfers between consumers and producers are neutral, that is, a dollar has the same value in the hands of a producer as it does in the hands of a consumer. The total surplus standard is the interpretation given to section 96 in the Competition Bureau's 1991 *Merger Enforcement Guidelines* and also in its 1998 *Merger Enforcement Guidelines as Applied to a Bank Merger*. The Tribunal applied the total surplus standard in the Initial Decision. The total surplus interpretation of section 96 was

subsequently ruled to be incorrect in law in the Appeal Judgment. In the Redetermination Decision, however, the Tribunal noted in general that, given the information required to identify redistributive effects, “... the assumption of neutrality could be appropriate in many circumstances.” [329] In the case at hand, the Tribunal concluded that there “... is considerable reason to think that portions, perhaps significant portions, of the measured transfer are redistributions of profit among shareholders that society would regard neutrally.” [366]

The fifth possible interpretation of section 96 considered by the Tribunal is what has become known as the balancing weights standard. It requires the Tribunal to solve for the relative weights at which producer gains and consumer losses are just equal and then decide if these relative weights are reasonable in the light of any disparity between the respective incomes of the consumers and shareholders involved. The Commissioner advocated the balancing weights interpretation of section 96 both initially before the Tribunal and then before the Federal Court of Appeal but not on the redetermination. The Federal Court of Appeal gave general approval to the balancing weights standard as an appropriate interpretation of section 96 in the Appeal Judgment. In the Redetermination Decision, the Tribunal indicated that, following the Court’s ruling in the Appeal Judgment, it would have applied the balancing weights approach had the evidence before it been sufficient to do so. [338] The Tribunal found that the balancing weight was 1.6 (consumer losses would have to be weighted at least 60% more heavily than producer gains in order to kill the merger) but also found that it had no basis on the evidence before it to determine whether a balancing weight of 1.6 was reasonable or not. In essence, the Tribunal ruled in the Redetermination Decision that the balancing weights standard is law but did not apply it. As will become apparent below, it did something quite different.

### **Total Surplus Versus Consumer Surplus: Licence to Monopolize or Vitiating?**

The Commissioner’s abandonment of the total surplus standard and his current advocacy of the consumer surplus standard appears to stem from his concern that the total surplus standard is too easy to meet. He appears to believe that under the total surplus approach, any price-increasing merger can successfully be defended simply by firing a president and a vice-president and that mergers to dominance or even monopoly can successfully be defended with little more. He wants a test that is tougher to pass. [170]

The argument that the total surplus standard constitutes a licence to dominate or even monopolize a market is simply and unambiguously wrong. Properly applied, the total surplus standard will be impossible to satisfy for the typical merger to monopoly or to dominance with inelastic demand. In their commentary on the Initial Decision, Mathewson and Winter have argued that the section 96 defence might not have saved the merger under the total surplus standard had the test been properly applied.<sup>8</sup> The Tribunal confirms this in the Redetermination Decision, noting that, had all the relevant evidence been properly introduced, the merger might not have survived the application of the total surplus standard. [167]

In a *Canadian Journal of Economics* paper, Bian and McFetridge calculated the percentage reductions in marginal (unit) cost that would be required to offset the unilateral anti-competitive price effects of mergers between symmetric Cournot oligopolists under the total and consumer surplus standards as well as the price standard. Some of their calculations are reproduced in Table 1 below.<sup>9</sup> Table 1 shows that a merger to monopoly from Cournot duopoly would require a 13% unit cost reduction to save it under the

total surplus standard when the market demand elasticity is 1.5 and a unit cost reduction of almost 9% to save it when the market demand elasticity is 2.

In a subsequent working paper, Bian and McFetridge calculated the percentage reductions in marginal (unit) cost that would be required to offset the unilateral anti-competitive price effects of mergers between members of a Cournot dominant group with a competitive fringe.<sup>10</sup> Some of their calculations are reproduced in Table 2 below. Table 2 shows that a merger to dominance (i.e. a merger leaving one firm in the dominant group) would require a unit cost reduction ranging from over 5% to over 11%, depending on the strength of the competitive fringe, to save it under the total surplus standard when the elasticity of market demand is 1.5.

In the Redetermination Decision, the Tribunal expressed the opinion that mergers will rarely result in eligible efficiency gains in excess of 5% [181]. Based on past experience, this is reasonable. The implication of this is that the efficiencies defence would rarely, if ever, save a merger to monopoly or dominance under the total surplus standard, properly applied.

The consumer surplus standard is generally much harder to satisfy than the total surplus standard. Table 1 shows that it would require an 18% unit cost reduction to save a merger to monopoly when the market demand elasticity is 1.5. But if the 13% required under the total surplus standard is unachievable, which it is, requiring more does not change anything. The point is that from the perspective of making a successful efficiencies defence of mergers to monopoly and mergers to dominance improbable if not impossible, the consumer surplus standard is simply redundant.

What about mergers in tight oligopoly situations? Table 1 shows that, under the total surplus standard, a merger to Cournot duopoly (a three to two merger) requires a unit cost saving of almost 6% to save it when the demand elasticity is 1.5. Again, an efficiencies defence would succeed rarely, if ever, under a total surplus standard. When demand is more elastic, mergers to duopoly or joint dominance could produce sufficient efficiencies to pass a total surplus test. It is in the case of four-to-three mergers that the total surplus standard becomes easier to satisfy and, depending on pre-merger shares, the nature of the cost-savings and the extent of any interdependent anti-competitive effects, can become automatic. With a consumer surplus standard, an efficiencies defence for a merger to duopoly is out of the question. This is also true of four-to-three and even five-to-four mergers when demand is relatively inelastic.

The Tribunal concludes that the consumer surplus standard must be wrong in law because it “vitiates” section 96 [214]. Section 96 would be vitiated by the consumer surplus standard if it were improbable that a merger could lessen competition substantially and avail itself of a successful section 96 defence. On the assumption that efficiency gains in excess of 5% are rarely achieved, the consumer surplus standard can be said formally to vitiate section 96 if it requires efficiencies in excess of 5% to save any merger lying outside the safe harbours in the *Merger Enforcement Guidelines*. It is apparent from Table 1 that the consumer surplus standard marginalizes rather than vitiates section 96. According to Bian and McFetridge’s simulations, it is theoretically possible to mount a successful efficiencies defence of a four-to three merger under the consumer surplus standard provided demand is sufficiently elastic and the efficiencies are substantial.

In essence, as far as mergers raising serious market power concerns are concerned, the adoption of the consumer surplus standard makes no difference. An efficiencies defence would not likely succeed under the total surplus standard, properly applied. It is in cases where market power concerns are less serious and efficiencies are substantial that the consumer surplus standard takes section 96 out of play. This begs the question of whether section 96 has ever been in play in these circumstances and what its effects have been. Have there been any actual cases in which anti-competitive four-to-three mergers resulting in large consumer losses have successfully defended themselves with trivial efficiencies under the total surplus standard? There are no litigated cases and no indication of this in the Commissioner's annual reports.

### **Balancing Weights Versus Consumer Surplus: Theologians Wanted**

The Tribunal interpreted the Appeal Judgment as obliging it to consider the redistributive effects of a merger in the sense of being prepared to weight consumer losses more heavily than producer gains. It interpreted the Appeal Judgment as giving general approval of the balancing weights approach suggested by the Commissioner's economic expert in *Superior Propane*, Professor Townley [335]. According to this approach, the Tribunal must make use of the socio-economic evidence before it to determine the extent and magnitude of any adverse distributional effect of the merger on consumers. Adverse redistributive effects are defined to have occurred if the merger has resulted in transfers of wealth from lower income to higher income groups. Having regard to the size of the transfer and the extent of the income disparity between the relevant consumers and shareholders, the Tribunal is then to assess on the basis of the evidence before it whether the extra weight that must be given to consumer losses to bring them into balance with producer gains is reasonable.

In his evidence in *Superior Propane*, Professor Townley declined to provide any guidance as to how the reasonableness of the balancing weight should be determined, having no basis in economics for doing so. He maintained that the reasonableness of the balancing weight was for the Tribunal to determine on the basis of unspecified public policy criteria. In the Redetermination Decision, the Tribunal responded that it is not a regulator and had no quasi-legislative or policy-development function [24]. Its lay members have expertise in competition matters but no specific industry expertise. They do not represent specific interest groups. The Tribunal views itself as an adjudicator, determining, if it must, the reasonableness of a balancing weight on the basis of the evidence before it rather than striking a balance among contending political interest groups [29]. It is not that the Tribunal ignores the public interest. Rather, it follows the *Competition Act* which itself defines the public interest [34].

In its mandated assessment of redistributive effects in the Redetermination Decision, the Tribunal found that increases in the price of bottled propane could be burdensome to low-income households that use propane for essential purposes and have no good alternatives [367]. It concluded that the balancing weights approach would deem the transfer of wealth from these low income households to Superior and ICG shareholders to be an adverse redistributive effect. It estimated the magnitude of the adverse redistributive effect to be the amount of the transfer from the lowest income quintile of household consumers of bottled propane to Superior and ICG shareholders [368]. The Tribunal found no reason to believe that the transfers from other households and businesses to Superior and ICG shareholders were adverse and treated them as being neutral. Thus, the vast bulk of the transfer from consumers to

producers resulting from the merger was treated by the Tribunal as it would be under the total surplus standard.

Having estimated the magnitude of the adverse wealth transfer, the Tribunal then turned to the question of the differential weight to be attached to it. The Tribunal found that if it simply added the \$2.6 million adverse redistributive transfer to the \$6 million deadweight loss in consumer surplus resulting from the merger, the anti-competitive effect would be \$8.6 million, still well below the \$29 million in efficiencies. Adding the adverse transfer to the deadweight loss is equivalent to giving the adverse transfer a balancing weight of 2 or to adopting the consumer surplus standard for those portions of the transfer deemed to be adverse. The Tribunal notes, however, that it has no statutory basis for this weighting. Transfers could as easily be weighted at half the deadweight loss because they are not lost to the economy. In the present case it doesn't matter since the excess of the efficiencies over the anti-competitive effect is so large [371]. The Tribunal gives no indication what it would have done had the choice of weight mattered. It is clear, however, that the Tribunal will not simply make up a weight.

The Tribunal rejected the consumer surplus standard for a variety of reasons, the most prominent being that it is inconsistent with the balancing weights test approved by the Court in the Appeal Judgment as an acceptable interpretation of section 96 [335, 366]. The Tribunal also concluded that the consumer surplus standard could not be correct in law because it vitiated section 96. As argued above, the Tribunal probably overstates the case with respect to vitiation.

The consumer surplus standard treats all consumer losses as if they were losses to the economy. It puts a zero value on the gains producers make at the expense of consumers. In Professor Townley's terms, it effectively assigns a balancing weight of 2 to the transfer from consumers to producers due to supra-competitive pricing post-merger.<sup>11</sup> The consumer surplus standard does not distinguish adverse from neutral transfers. All transfers from consumers to producers resulting from anti-competitive pricing are equally adverse regardless of differences in the socio-economic status of those involved.

The Commissioner referred to the jurisprudence under section 45 of the *Competition Act* in support of his choice of the consumer surplus standard [71]. The usual interpretation of section 45 is that there is no defence for an undue lessening of competition. The public has a right to the benefits of free competition and an undue impairment of that right violates the Act regardless of how beneficial it might be to the parties to the agreement. This begs the question of what constitutes an undue lessening of competition. The Tribunal properly questions the relevance of jurisprudence on the interpretation of undueness in criminal conspiracies to a "full-blown" rule of reason analysis under civil law [77].

The Commissioner argued in the redetermination that all transfers from consumers to producers resulting from an anti-competitive merger are adverse regardless of whether the consumers are richer or poorer than the producers. In his view, the *Competition Act* does not distinguish between rich and poor consumers or between luxuries and necessities [184]. It is, however, one thing to argue that any transfer from consumers to producers resulting from an anti-competitive merger is necessarily adverse, it is quite another to argue that it is so adverse that it should always be treated as if the wealth involved had simply vaporized.

In the Tribunal's view, assuming that the redistribution of wealth from consumers to producers resulting from anti-competitive pricing can never be neutral or even weakly adverse is not the correct interpretation of the Act [186]. The Tribunal is not obliged mindlessly to assign a balancing weight of 2 to all transfers from consumers to producers. It is up to the Tribunal to determine the magnitude of any adverse transfers and the differential weight to assign to them in the light of the evidence before it. The Tribunal may treat some transfers of wealth between consumers and producers as if this wealth had vanished off the face of the earth but it is not obliged to do so in all cases.

The Tribunal argues that if the Court had wanted the Tribunal to adopt the consumer surplus standard, it would surely have stated so in the Appeal Judgment. Beyond being required to recognize that the anti-competitive effects of a merger are not confined to those implied by the total surplus standard, the choice of methodology for determining the magnitude of the anti-competitive effects has been left by the Federal Court of Appeal to the Tribunal [369].

While it recognized that it must depart from the total surplus standard if confronted with evidence of adverse redistributive effects, the Tribunal nevertheless defended the fundamental soundness of the total surplus approach. It rejected the general argument that the total surplus standard results in the automatic acceptance of an anti-competitive merger [173]. With respect to *Superior Propane*, the Tribunal suggests that if the Commissioner had introduced the available evidence on the effects of the lessening of competition properly, the efficiencies defence might well have failed under the total surplus standard and the Commissioner would have been granted the divestiture order he sought [167-169].

The Tribunal also defended the clarity of the total surplus approach. Dr. Schwartz stated in his concurring opinion in the Redetermination Decision that section 96 is clear if one adopts a total surplus standard [383]. It becomes murky only when laden with distributive and other public policy concerns as the Court attempted to do in the Appeal Judgment.

The Tribunal also signalled that the total surplus standard could survive as a default standard when there is no conclusive evidence regarding the adverse redistributive effects resulting from a merger. The key assumption of the total surplus standard is distributive neutrality. The Tribunal noted that, given the information required to identify redistributive effects, "... the assumption of neutrality could be appropriate in many circumstances." [329]

### **The Tribunal's Response to Other Competition Issues Raised on Appeal**

The Appeal Judgment obliged the Tribunal to reconsider its initial decision in the light of a number of arguments raised by the Commissioner. In the Redetermination Decision, the Tribunal disposed of some of these arguments and fitted others into the existing merger review framework.

The Tribunal disposed of a number of the Commissioner's arguments on the grounds that: (1) he had not made them during the initial hearing or; (2) if he had made these arguments, he had led no evidence or insufficient evidence to support them or; (3) they were already incorporated in the Tribunal's findings with respect to the anti-competitive effect of the merger. Arguments dismissed in this manner include: (1) additional consumer losses from interdependent pricing; (2) additional consumer losses from the

prevention of competition in Atlantic Canada; (3) loss of dynamic efficiencies; (4) loss of service quality and discontinuation of special programs.

The Tribunal also addressed the Commissioner's conceptual arguments. These arguments were: (1) that the creation of a monopoly has anti-competitive consequences beyond its market power consequences as assessed under section 93; (2) that the section 96 defence should not be available in cases of merger to monopoly; (3) that the anti-competitive effects of a merger include any adverse effects on the opportunities for equitable participation by small and medium-sized business in the Canadian economy and; (4) that consumer losses in related downstream markets should be added to consumer losses in the relevant market in the determination of the magnitude of the anti-competitive effect. The Tribunal also revisited statements made in the Appeal Judgment regarding the role of the elasticity of demand in the determination of the deadweight loss.

### *Monopoly!*

The Tribunal has correctly rejected the argument that the term "monopoly" has some meaning beyond its normal market power interpretation. Labelling the merged entity as a monopoly neither adds to nor detracts from the determination of its ability to exercise market power [272]. The related proposition that section 96 is not available in cases where the merged entity's market share is 100% while remaining available when the merged entity's market share is, say, 96% has now also been disposed of and properly so [277].

### *Small and Medium-Sized Business*

With respect to small and medium-sized business, the Tribunal has properly considered this factor in conventional section 93 terms. Specifically, it asks whether the merger will result in a reduced intensity of fringe competition or increased barriers to entry or mobility [301]. The Tribunal found that small and medium-sized competitors would probably behave more interdependently, pricing up to the dominant firm but that this was part of the lessening of competition it had already found.

The Tribunal also accepted that it now had an obligation to consider any harm to small and medium-sized business resulting from the merger. It interpreted this obligation as requiring it to inquire whether the merger would give rise to predatory or exclusionary conduct that would be offensive under section 50 or 79 [305]. The Tribunal found that it could not infer this outcome on the basis of the evidence before it.

### *Related Markets*

The Tribunal accepted the principle that deadweight consumer losses in related (downstream) markets should be added to the anti-competitive effects of a merger [255]. It also accepted that there may be adverse redistributive consequences in related markets and these should be taken into account if they can be identified.

Simply adding consumer losses in related downstream markets to consumer losses in the relevant market is double-counting if downstream markets are competitive. The demand for propane by intermediate goods producers is a derived demand. The area under the derived demand schedule represents the surplus

of downstream users. There is no need to count it again. The issue is more complicated if the downstream is imperfectly competitive.

### *The Elasticity Gaffe*

In his concurring opinion, Dr. Schwartz, a lay member of the Tribunal, pointed out that the Appeal Judgment erred in asserting that the total surplus standard has paradoxical consequences in that it makes it easier to justify a merger between suppliers of goods for which demand is relatively inelastic than of goods for which demand is relatively elastic [396-398]. The Federal Court of Appeal was indeed quite wrong in its assertion. The opposite is true. The lower the price elasticity of demand, the greater is the efficiency gain required to satisfy the total surplus standard. Professor Ware has pointed this out.<sup>12</sup> It is also apparent from Tables 1 and 2 in this paper and from the discussion above. The related argument (Appeal Judgment, para. 106) that the total surplus standard is defective because it implies a differential treatment of mergers based on the elasticity of market demand is also incorrect. It is true that the lower is the elasticity of demand, the *more* difficult it is to satisfy the total surplus standard. But this is also true of the price, consumer surplus and balancing weights standards.

### **Where Do We Stand?**

If it stands, the Redetermination Decision could leave the merger review process essentially intact if somewhat more complex. The total surplus standard appears to remain in place as the default standard from which the Tribunal will deviate when presented with evidence that the price increases resulting from an anti-competitive merger will be visited on the lowest tier (perhaps fifth) of the income distribution for whom the product involved is a necessity. If he wants redistributive effects to be considered, the Commissioner will have to prove them. In this sense, it appears as if the Commissioner has increased the evidentiary burden on himself.

The situation may be changed yet again depending on the outcome of the Commissioner's appeal. Whatever the Federal Court of Appeal does, it seems unlikely to order the Tribunal to adopt the consumer surplus standard proposed by the Commissioner. The Court has already stated in the Appeal Judgment that the choice of an alternative to the total surplus standard is beyond the limits of its competence (Appeal Judgment, para. 139). The Tribunal is quite clear that an order to adopt the consumer surplus standard would be an intrusion on the Tribunal's area of expertise [369]. The Commissioner could seek other remedies at the appellate level. These might curtail the Tribunal's use of the total surplus standard as a default standard or oblige the Tribunal to promulgate distributional weights even when it has no evidentiary basis for doing so.

### *Are Amendments to Section 96 Required?*

If past experience is any guide, there will be continued legislative tinkering and, of course, stakeholder consultations. While the task force recommended by the Industry Committee in its recent report might be a means of providing the Tribunal with some direction as to how it should determine the reasonableness of a balancing weight, it would not necessarily clarify matters and the status of its recommendations would be uncertain.<sup>13</sup> There is also reason to be sceptical about the ongoing amendment process which

appears to be driven by the cases the Commissioner loses rather than by objective analysis of defects in the statute (section 61 of the *Competition Act* being the most glaring example of this).

The most obvious amendments to section 96 are those currently before Parliament in Bill C-248.<sup>14</sup> Bill C-248 would restrict eligible efficiency gains under section 96 to those which are being or are likely to be passed on to customers in the form of lower prices within a reasonable period of time. If this means that prices must fall post-merger by the amount of the efficiency gains, then this is Pitofsky's "killer qualification." It could also mean that only savings in marginal or variable costs are eligible to be considered for purposes of section 96. As participants in predatory pricing cases can attest, determination of what costs might be variable in any given instance is highly problematic. If savings in fixed costs were not eligible under section 96, this would rule out economies of density. It would rule out economies derived from rationalization such as the elimination of set-up or change-over costs. It would rule out efficiencies in R&D, marketing and capacity expansion.

Bill C-248 also proposes to make a section 96 defence unavailable in situations in which a merger creates or strengthens a dominant position. This proposed dominance exclusion is a variant on the Commissioner's argument, already rejected by the Tribunal, that section 96 cannot apply in cases of merger to monopoly. It reflects the misapprehension, discussed at length above, that a successful defence for mergers to dominance is routinely available under a total surplus interpretation of section 96. The creation or strengthening of dominance is simply a way of describing an increase in market power. The anti-competitive effects of an increase in market power depend on the section 93 factors. While some of these factors may be more important in some instances than in others, it is the resulting increase in market power rather than the label attached to it that matters. Once the anti-competitive effects of an increase in market power have been established, there is no reason to allow for an efficiencies defence in some cases and not in others.

If the Commissioner does not succeed in doing so through the appeal process, he might seek to amend section 96 to require that it be given a consumer surplus interpretation. The Commissioner has apparently embraced the consumer surplus standard, first, in the mistaken belief that the total surplus standard is too easy to meet and, second, in the belated recognition that the balancing weights standard that he and his expert originally proposed is unworkable. As argued above, it is highly unlikely that mergers either to monopoly or to dominance could pass a properly-applied total surplus test. For these kinds of mergers, the consumer surplus standard is overkill. While the consumer surplus standard may have the added attraction to the Commissioner of limiting the application of the efficiencies defence in more competitive market situations, this is not or should not be the point. The consumer surplus standard will allow mergers that hurt consumers as consumers and forbid mergers that benefit the economy as a whole. It does not distinguish between the transfer of wealth and the destruction of wealth. The consumer surplus standard is acknowledged to have no basis in welfare economics. Proposing to interpret a statute that is often touted as being one of the most economically literate in the world in this way is ironic but it is hard to appreciate the irony.

### *If It Ain't Broke ...*

The Redetermination Decision appears to have given the Commissioner another possible course of action. He could simply enforce the *Competition Act* as interpreted by the Tribunal. The Commissioner now has

the option of introducing evidence that the transfer from consumers to producers resulting from an anti-competitive merger is regressive. If he does not avail himself of this opportunity, the Tribunal is likely to revert to the total surplus standard as a default interpretation of section 96. Other than *Superior Propane* in which the Commissioner might have prevailed had he presented his evidence differently, there is absolutely nothing in the public record to indicate that the total surplus standard has thwarted the Commissioner's enforcement efforts or that anti-competitive mergers have slipped through on the basis of trivial efficiencies. The Commissioner could devote additional attention, first, to the measurement of anti-competitive effects. Second, if he truly thinks that efficiencies typically adduced for purposes of section 96 are exaggerated or even contrived, he could devote more effort to demonstrating that this is the case.<sup>15</sup>

Table 1

Percentage Cost Reductions Required to Satisfy the Profitability Requirement and the Price, Total Surplus and Consumer Surplus Standards

Number of Firms Post-Merger	Elasticity of Demand	Percentage Reduction in Cost Required to Satisfy:			
		Profitability Requirement	Price Standard	Total Surplus Standard	Consumer Surplus Standard
1	1.5	0.00	50.00	13.30	17.70
1	2.0	0.00	33.33	8.87	11.80
1	2.5	0.00	25.00	6.65	8.85
2	1.5	3.47	28.57	5.84	10.81
2	2.0	2.43	20.00	4.09	7.57
2	2.5	1.87	15.38	3.14	5.82
3	1.5	4.38	20.00	3.34	7.78
3	2.0	3.13	14.29	2.39	5.56
3	2.5	2.43	11.11	1.86	4.32
4	1.5	4.12	15.38	2.18	6.07
4	2.0	2.98	11.11	1.58	4.38

Source: L. Bian & D. McFetridge, "The Efficiencies Defence in Merger Cases: Implications of Alternate Standards", *infra* note 9, equations (8), (9), (10), (13) and (15).

Table 2

## Percentage Cost Reduction for an Efficiencies Defence of a Merger to Dominance

Fringe Market Share (%)	Fringe Supply Elasticity	Market Demand Elasticity	Price Standard %	Total Surplus Standard %	Consumer Surplus Standard %
0	0	1.5	50.00	13.33	17.70
10	0	1.5	42.86	11.40	16.59
20	0	1.5	36.36	9.67	15.49
30	0	1.5	30.43	8.10	14.38
10	1	1.5	39.13	10.41	15.23
20	1	1.5	30.77	8.18	13.22
30	1	1.5	24.14	6.42	11.53
10	2	1.5	36.00	9.58	14.08
20	2	1.5	26.67	7.09	11.54
30	2	1.5	20.00	5.32	9.62
0	0	2	33.33	8.87	11.80
10	0	2	29.03	7.72	11.24
20	0	2	25.00	6.65	10.65
30	0	2	21.21	5.64	10.02
10	1	2	27.27	7.25	10.60
20	1	2	22.22	5.91	9.53
30	1	2	17.95	4.77	8.55
10	2	2	25.71	6.84	10.03
20	2	2	20.00	5.32	8.66
30	2	2	15.56	4.14	7.46

Source: L. Bian & D. McFetridge, “Efficiencies Defences for Mergers within a Dominant Group”, *infra* note 10, equations (15), (16), (17) and (19) with consumer surplus standard added.

## Notes

- <sup>1</sup> Department of Economics, Carleton University, Ottawa..
- <sup>2</sup> *Canada (Commissioner of Competition) v. Superior Propane Inc.*, 2001 FCA 104 (the “Appeal Judgment”).
- <sup>3</sup> *Canada (Commissioner of Competition) v. Superior Propane Inc.* (2000), 7 C.P.R. (4th) 385 (the “Initial Decision”).
- <sup>4</sup> *The Commissioner of Competition v. Superior Propane Inc.*, [2002] C.C.T.D. No. 10 (the “Redetermination Decision”) [numbers cited refer to paragraph numbers in the decision unless otherwise specified].
- <sup>5</sup> Bill C-248, *An Act to amend the Competition Act*, 1st Sess., 37th Parl., 2001 (1st reading 7 February 2001).
- <sup>6</sup> R. Pitofsky, “Proposals for Revised United States Merger Enforcement in a Global Economy” (1992) 81 *The Georgetown Law Journal* 207.
- <sup>7</sup> *Canada (Director of Investigation and Research) v. Hilldown Holdings Canada Ltd.* (1992), 41 C.P.R. (3d) 289.
- <sup>8</sup> Mathewson and Winter, “The Analysis of Efficiencies in *Superior Propane*: Correct Criterion Incorrectly Applied” (2000) 20:2 *Can. Comp. Rec.* 88.
- <sup>9</sup> L. Bian & D. McFetridge, “The Efficiencies Defence in Merger Cases: Implications of Alternate Standards” (2000) 33 *Canadian Journal of Economics* 297.
- <sup>10</sup> L. Bian & D. McFetridge, “Efficiencies Defences for Mergers within a Dominant Group” Carleton University Department of Economics Working Paper 00-09 (October 2000).

<sup>11</sup> See also D.G. McFetridge, "The Efficiencies Defense in Merger Cases" in M.B. Coate & A.N. Kleit, eds., *The Economics of the Antitrust Process* (Boston: Kluwer Academic Publishers, 1996) 103.

<sup>12</sup> Ware, "Is Competition Economics "Beyond the Ken of Judges"? The Federal Court of Appeal Ruling in *Superior Propane*" (2001) 20:3 Can. Comp. Rec. 1.

<sup>13</sup> "A Plan to Modernize Canada's Competition Regime" (Report of the Standing Committee on Industry, Science and Technology, House of Commons, April 2002) at 101.

<sup>14</sup> *Supra* note 5.

<sup>15</sup> For a commentary on eligible efficiencies and standards of proof in *Superior Propane*, see Gudofsky and Gay, "Long Live the *Merger Enforcement Guidelines*? A Review of the *Superior Propane* Decision" (2000) 20:2 Can. Comp. Rec. 46.

