ARTICLE DE LA REVUE JURIDIQUE THÉMIS

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The Efficiency Defence and its Interpretation in *Superior Propane*: Reversed Robinhoodism at its Worst*

Kamil Gérard AHMED**

Résumé

D'importants débats doctrinaux ont eu lieu depuis que la Cour d'appel fédérale a rendu son jugement définitif dans l'affaire Canada (Commissaire de la concurrence) *c.* Supérieur Propane Inc. *Il est largement accepté que la défense fondée sur les gains en efficience, visée à l'article 96 de la Loi sur la concurrence, a reçu une application erronée et que le Tribunal de la concurrence et la Cour d'appel fédérale ont erré en droit. Les anciens commissaires de la concurrence et ceux d'aujourd'hui se sont promis d'abroger la défense entière visée à l'article 96 relativement à une fusion qui serait, par ailleurs, de nature non concurrentielle. La politique en matière de concurrence a pour objectif clair la promotion de*

Abstract

Significant doctrinal debate has taken place since the Federal Court of Appeal rendered its final judgment in Canada (Commissioner of Competition) *v.* Superior Propane Inc. *It is widely accepted that the efficiency defence, prescribed at section 96 of the Competition Act, was incorrectly applied and the Competition Tribunal and Federal Court of Appeal erred in law. Former and present Commissioners of Competition have vowed to repeal section 96 as a plenary defence to an otherwise anti-competitive merger. Promoting efficiency in the Canadian economy is clearly the overriding objective of competition policy, and it is laudable, but efficiency in and of itself means little where it does*

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* This article represents the state of law as of September 1, 2006.

** JD/MBA (Toronto), LLB (Civil Law) (Sherbrooke), BA (Poli. Sci.) (Concordia). I would like to thank Prof. Edward M. Iacobucci of the University of Toronto, Faculty of Law, for his comments and revisions of a prior draft, and Robert J. Morin of the Competition Bureau for his thoughts. Of course, the opinions of this article and any mistakes found therein remain my own.

l'efficience dans l'économie canadienne. Cette démarche est louable ; cependant, l'efficience à elle seule représente peu si elle n'est pas un moyen permettant d'arriver à une fin. L'efficience a pour but d'améliorer le sort des Canadiens, mais l'ensemble des Canadiens a été lésé par l'application de la défense fondée sur les gains en efficience dans l'affaire Supérieur Propane *– certains services ont été réduits, on a observé l'apparition de fusions créant des monopoles dans de nombreux marchés régionaux et surtout, le prix du propane a augmenté d'au moins 8 % à l'échelle nationale. Les consommateurs pauvres ont ainsi transféré leur peu de richesse aux producteurs fortunés, l'inverse de Robin des bois en d'autres termes. Force est de constater que l'efficience ne fonctionne pas comme critère en vase clos et qu'elle ne peut à elle seule constituer le fondement des prises de décisions importantes dans l'intérêt des Canadiens.*

Le présent exposé appuie le fait que le Parlement devrait modifier la défense fondée sur les gains en efficience. La création d'efficiences au sein de l'économie canadienne est essentielle pour conserver, voire même augmenter, la compétitivité des entreprises et de l'économie canadiennes sur la scène internationale. Toutefois, il n'est pas équitable que les entreprises canadiennes souhaitant établir des alliances stratégiques par le biais de fusions et d'acquisitions profitent du double avantage (i) économies et (ii) recettes supérieures issues de l'augmentation des prix, le premier étant justifié alors que le deuxième ne l'est pas. C'est dans cette optique que la

not constitute a means to an end. Efficiency is ultimately meant to better the lot of Canadians, but Canadian consumers as a whole were prejudiced by the efficiency defence's application in Superior Propane *– services were reduced, mergers-to-monopoly occurred in many regional markets and most importantly, the price of propane increased by at least 8% nationwide. Poorer consumers thus transferred their wealth to richer producers which lead to a situation of "reversed robinhoodism." Efficiency obviously does not operate in a vacuum and cannot alone be the helmsman of sound policy-making for the benefit of all Canadians.*

This paper argues that Parliament must amend the efficiency defence. The creation of efficiencies in the Canadian economy is essential to maintain and hopefully increase the competitiveness of Canadian firms and the Canadian economy internationally. Nevertheless, it is inequitable for Canadian companies seeking strategic alliances through mergers and acquisitions to benefit from the two-fold advantage of (i) cost savings, and (ii) higher revenue resulting from price increases. The former is justified but the latter is not. It is in this light that the efficiency defence further to the total surplus and balancing weights approaches is unjustifiable because Canadian consumers transfer their wealth to wealthier producers. This paper proposes an ex ante price maintenance standard for the efficiency defence where Canadian firms can benefit from cost savings but generally not from higher prices; consumer protection will thus be significantly fur-

défense fondée sur les gains en efficience, en plus des méthodes du surplus total et des pondérations d'équilibrage, n'est pas justifiable, car les consommateurs canadiens transfèrent leurs avoirs aux producteurs riches. Cet exposé propose une norme de système de prix imposés ex ante pour la défense fondée sur les gains en efficience qui permettra aux entreprises canadiennes de tirer profit des économies mais pas de l'augmentation des prix en règle générale. La protection des consommateurs sera ainsi améliorée alors que les entreprises pourront profiter des efficiences. La transaction contestée dans l'affaire Supérieur Propane *n'aurait pas été autorisée en vertu de cette norme. Cependant, si les prix devaient augmenter de façon importante après une fusion, les consommateurs et les parties intéressées ne seraient pas privés de leur droit d'intenter une action en justice et la réglementation après la fusion pourrait alors entrer en vigueur. La réglementation* ex post *serait toutefois réservée aux circonstances exceptionnelles pour préserver l'efficience et la protection accessoire des consommateurs.*

thered, all the while permitting firms to garner efficiencies. The impugned transaction in Superior Propane *under this standard would not have been approved. However, in the event that prices significantly increase post-merger, consumers and other stakeholders should not be precluded from legal action, and ex post merger regulation could then possibly take effect.* Ex post *regulation should nevertheless be reserved to exceptional circumstances for sake of efficiency and corollary consumer protection.*

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Canada has traveled a path full of pitfalls and crevices in its enactment of the *Competition Act*[1] in 1986 and has sparse experience in applying this statute despite its legislative antecedents dating back to 1889[2]. The efficiency defence, prescribed at section 96 of the *Competition Act*, was first enacted in 1986. *Canada (Commissioner of Competition)* v. *Superior Propane Inc.*[3] is the sole case in Canada having applied the defence and constitutes a watershed in competition law. Most competition law scholars agree that it is the single most important decision since 1986[4].

In her address to the Canadian Bar Association Annual Conference on Competition Law, the Commissioner of Competition, Sheridan Scott asks "whether or not circumstances have evolved in Canada, such that the efficiencies defence is no longer justified"[5]. Similarly, the issue before a recent competition policy conference "was whether the merger review process [in Canada] has become dysfunctional"[6]. *Superior Propane* goes to the core of competition policy, but this paper argues that both the Competition Tribunal and Federal Court of Appeal ("FCA") rendered questionable decisions. Questioning the efficiency defence is not novel – certain scholars believe it was undefined from its very beginnings[7]. Similarly, former Commissioners of Competition have argued for its

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1 *Competition Act*, R.S.C. (1985), c. C-34.

2 *An Act for the Prevention and Suppression of Combinations Formed in Restraint of Trade*, S.C. 1889, 52 Vic., c. 41.

3 *Canada (Commissioner of Competition)* v. *Superior Propane Inc.*, (2000) (Comp. Trib.) (hereinafter "*Tribunal 2000 Decision*"), rev'd [2001] F.C.A. 104 (hereinafter "*FCA 2001 Decision*"), remanded (2002) 18 C.P.R. (4th) 417 (Comp. Trib.) (hereinafter "*Tribunal 2002 Decision*"), aff'd [2003] F.C.A. 53 (hereinafter "*FCA 2003 Decision*").

4 See for example: Stanley WONG, "The Superior Propane Case and the Future of Canadian Merger Law", (2000) 20(2) *Can. Comp. Rec.* 1.

5 "Speaking Notes for Sheridan Scott Commissioner of Competition", *Competition in a Dynamic Marketplace* before the Canadian Bar Annual Conference on Competition Law, 23 September 2004,, at 12, online: [http://competition.ic.gc.ca/epic/internet/incb-bc.nsf/vwapj/ct02950eeCBAfinal.pdf/$FILE/ct02950eCBAfinal.pdf] (date accessed: 31 October 2004) (hereinafter "*Speaking Notes for Sheridan Scott 1*").

6 Donald McFETRIDGE, "Efficiencies Standards: Take your Pick", (2002) 21(1) *Can. Comp. Rec.* 45.

7 Margaret SANDERSON, "Efficiencies Analysis in Canadian Merger Cases", (1997) 65 *Antitrust Journal* 623, 625.

repeal, but Sheridan Scott's statement is important because it represents the Competition Bureau's current stance.

Superior Propane is demonstrative of problems with the efficiency defence – the post-merger price of propane in Canada was *ex ante* forecasted to increase by 8%[8], yet was approved under the total surplus and balancing weights standards. The argument of this article is one of deceptive simplicity. The efficiency defence can harm consumers and Parliament should consequently amend section 96 of the *Competition Act* to protect consumer interests. The defence's very notion seems counterintuitive to competition policy and has led to "reversed robinhoodism"– poorer consumers transferring their wealth to richer producers. The efficiency defence may function properly in a closed economy, but the Canadian economy is open and cost savings created by mergers are often exported abroad. Moreover, Canadian competition law must be interpreted in a specific context. Section 1.1 of the *Competition Act* states that:

> *The purpose of this Act is to maintain and encourage competition in Canada in order* to promote the efficiency and adaptability of the Canadian economy*, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy* and in order to provide consumers with competitive prices and product choices.[9]

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8 The Tribunal states that the average price of propane would at least increase by 8% post-merger after the merging firms realize their projected cost savings, and the evidence indeed indicates the merged entity would have a lower cost structure for a number of reasons. The price increase is therefore entirely attributable to greater profitability as opposed to a higher cost structure. The Tribunal decided that the price of propane would increase by 8% per the evidence of economist Michael Ward in Confidential Exhibit CA-2060. See: *Tribunal 2000 Decision*, *supra* note 3 at paras. 252 and 253; *FCA 2001 Decision*, *supra* note 3 at para. 36. But the evidence indicates that the range of price increase is between 7 to 11%, and a number of authors in turn refer to a 9% increase. See: Stephen F. ROSS, "The Political Economy of the Efficiency Defence", (2002-2003) 21(2) *Can. Comp. Rec.* 89; Frank MATHEWSON & Ralph A. WINTER, "The Analysis of Efficiencies in Superior Propane: Correct Criterion Incorrectly Applied", (2000) 20(2) *Can. Comp. Rec.* 88, 90 and 93. Although an 8% and 9% post-merger price increase both seem reasonable, I will refer to 8% as the price increase throughout this article.

9 *Supra* note 1 (emphasis added).

This purpose clause has conflicting objectives but nevertheless carries the same weight as other provisions of the *Competition Act*[10]. The FCA in *Superior Propane* ruled that the balancing weights approach is preferable to the total surplus approach but normatively, the crucial issue is whether this ruling is correct. This paper argues that the balancing weights approach is lacking and proposes the adoption of a price maintenance standard – product prices must be *ex ante* determined to remain stable or decrease post-merger, exceptions notwithstanding, while efficiencies are garnered by the merging firms. The price maintenance standard is not without fault economically but results in a positive-sum game for competing stakeholders, including consumers, producers and nation-state efficiency. Part I of this paper analyzes merger law in Canada, and particularly discusses *Canada (Director of Investigation and Research)* v. *Hillsdown Holdings (Canada) Ltd.*[11] and *Superior Propane* decisions in detail. Part II rejects Bill C-249 as a legislative proposal and details this paper's recommendation: the price maintenance standard.

I. Merger Law in Canada

Section 92 of the *Competition Act* requires the analysis of whether a merger leads to a substantial lessening of competition in Canada. If the Competition Tribunal, upon application of the Commissioner of Competition answers this question in the affirmative, it can prohibit the proposed merger from taking place *ex ante* or can dissolve the merger or require divestiture of certain assets *ex post*[12]. Despite the Competition Tribunal's mention that efficiencies are only relevant when applying section 96 of the *Competition Act*, Ross argues they are also relevant in a section 92 analysis. Evidence regarding the lower costs of merging firms can indicate they are unlikely to collude with competitors. These mergers would thus not substantially lessen competition[13]. Furthermore, section 92 is subject to sections 94 to 96 of the *Competition Act*. Subsection 96(1) provides

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10 *FCA 2001 Decision*, *supra* note 3 at para. 87 citing *Driedger on the Construction of Statutes*.

11 *Canada (Director of Investigation and Research)* v. *Hillsdown Holdings (Canada) Ltd.*, (1992) 41 C.P.R. (3d) 289 (Comp. Trib.) (hereinafter "*Hillsdown*").

12 See: *Competition Act*, *supra* note 1, s. 92.

13 S.F. ROSS, *loc. cit.*, note 8, 97.

that the Competition Tribunal will not make a section 92 order where the consequences of a merger or proposed merger lead to a substantial lessening of competition, but efficiency gains offset anti-competitive effects that could not otherwise be achieved. In assessing these efficiency gains, the Competition Tribunal must assess whether real export values[14] or substitution of domestic products for imported products[15] has significantly increased.

Parliament, in principle, intended the rejection of mergers on the basis of their anti-competitive effects (s. 92) but acceptance for efficiency reasons (s. 96). However, Ross argues "[i]t is not clear … that Parliament possessed 20-20 vision in foreseeing that the Tribunal and the Commissioner would necessarily apply section 92 in the sophisticated and rigorous way that it has been applied"[16]. This may explain the lack of section 96 cases until *Superior Propane*. The two judgments having discussed the efficiency defence will now be analyzed: *Hillsdown* and *Superior Propane*.

A. *Canada (Director of Investigation and Research) v. Hillsdown Holdings (Canada) Ltd.*

This case discussed the efficiency defence in *obiter dicta* because the Competition Tribunal did not find that a substantial lessening or prevention of competition would likely result from the merger. The facts of the case are simple. Hillsdown Holdings (Canada) Ltd. ("Hillsdown") acquired a majority of common shares of Packers, Inc., which is the parent company of Ontario Rendering Company Ltd ("ORC"). Hillsdown owned a meat rendering company, Rothsay, which carried on business in southern Ontario – its main competitor in the area was ORC. The merger of these competing companies would confer the resulting entity between 62% and 63% of the red meat market in southern Ontario. The Director of Competition (as the position then was) contested Hillsdown's acquisition of ORC.

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14 *Competition Act*, *supra* note 1, s. 96(2)(a).

15 *Id.*, s. 96(2)(b).

16 S.F. ROSS, *loc. cit.*, note 8, 95.

After Justice Reed rendered judgment, uncertainty existed on the role of efficiencies in the merger review process[17], specifically whether a total surplus or consumer welfare standard was created. Regarding the efficiency defence, Reed J. stated that efficiencies must likely result from a merger but need not exclusively arise from it. She questions whether the efficiency defence encompasses more than the total surplus standard on the basis that Parliament would have expressly worded section 96 to include deadweight loss or allocative inefficiency as the only relevant factor in interpreting the efficiency defence[18]. The legislative history indicates that Parliament first intended section 96 to assess efficiency gains without considering economic costs arising from a substantial lessening of competition. However, Parliament ultimately opted for a different direction when the *Competition Act* was enacted. The Competition Tribunal must therefore weight the contended efficiency gains against the probability of negative effects resulting from a substantial lessening of competition[19].

The Competition Tribunal discusses four goals of competition law in *Hillsdown*[20]. The first three are distributive in nature. First, consumers require protection through competitive prices. Second, competition law vies "… to encourage the dispersal of power and the distribution of wealth"[21]. Third, protecting smaller firms from larger and stronger competitors is important. Economic arguments notwithstanding, these three objectives demonstrate the political sensitivity of transferring wealth from consumers to producers. Merged

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17 Michael TREBILCOCK & Ralph A. WINTER, "The State of Efficiencies in Canadian Merger Policy", (1999-2000) 19(4) *Can. Comp. Rec.* 106, 112. See: Paul S. CRAMPTON, "The Efficiency Exception for Mergers: an Assessment of Early Signals from the Competition Tribunal", (1993) 21 *Can. Bus. L.J.* 371; Lawrence P. SCHWARTZ, "The 'Price Standard' or the 'Efficiency Standard': Comments on the Hillsdown Decision", (1992) 13(3) *Can. Comp. Pol. Rec.* 42.

18 *Hillsdown*, *supra* note 11, 337; Calvin S. GOLDMAN & John D. BODRUG, "The Hillsdown and Southam Decisions: The First Round of Contested Mergers Under the Competition Act", (1993) 38 *McGill L.J.* 724, 736 and 737.

19 Negative effects include allocative inefficiency and wealth transfers. See: *Hillsdown*, *supra* note 11, 343.

20 *Id.*, 338 and 339, referring to the text of Robert WHISH, *Competition Law*, London, Butterworths, 1985.

21 *Id.*

entities that charge consumers with higher prices to maximize revenue will undoubtedly be unpopular with consumers[22]. Finally, competition law vies to promote economic efficiency[23]. These distributive and economic objectives are opposed in many ways, but this paper agrees with the FCA's statement in *Superior Propane* that distributive concerns are not inimical to the goals of competition policy.

> *Like other regulatory administrative tribunals, the Tribunal is charged with the responsibility of protecting the public interest, which it does by striking a balance among conflicting interests and objectives in a manner that respects the text and purposes of the legislation, is informed both by technical expertise and by the judgment that comes from its members' varied experiences, and is responsive to the particularities of the case.*[24]

Conflicting objectives exist in the purpose clause of the *Competition Act*. Reed J. refers to statements of the *Competition Act*'s responsible minister in the House of Commons where "… providing consumers with competitive prices and product choices was the overriding concern of the Act"[25]. Tyhurst similarly notes that this is the clearest objective in the purpose clause[26]. Of course, a minister's statements must be placed in context because courts are not bound by these statements. In *Re B.C. Motor Vehicle Act*[27], the Supreme Court of Canada rejected the interpretation of fundamental justice by the Minister of Justice, Jean Chrétien (as he then was), because his interpretation had minimal weight relative to other reasons to extend the concept's meaning[28].

In *Hillsdown*, Reed J. remarked that a decrease in post-merger product price is indicative of efficiency pursuant to section 96. Goldman and Bodrug, however, question the soundness of this rea-

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22 *Hillsdown*, *supra* note 11, 338 and 339, citing R. WHISH, *op. cit.*, note 20 at 12-15 and 30.

23 *Id.*

24 *FCA 2001 Decision*, *supra* note 3 at para. 98.

25 *Hillsdown*, *supra* note 11, 339 and 340, citing House of Commons Debates (7 April 1986), 11927.

26 John S. TYHURST, "The Superior Propane Decision: Common Sense Overcomes Geometry, or how the Federal Court of Appeal Squared the Triangle", (2001) 20(3) *Can. Comp. Rec.* 8, 9.

27 [1985] 2 S.C.R. 486.

28 *Id.*, 509.

soning because a price decrease is unlikely to substantially lessen competition and an analysis under the efficiency defence would thus be unnecessary[29]. Efficiency is based on the assumption that a dollar in the hand of any person is worth the exact same thing[30], and the efficiency defence is based on this premise. Nevertheless, it has been argued that Parliament would not enact legislation that goes against the interests of most Canadians because more Canadians are in lower income brackets than in higher income brackets[31]. Reed J. similarly questioned in *Hillsdown* whether the absolute neutrality of wealth transfers is correct, and indicates her disapproval against a bright-line rule that only assesses the deadweight loss to the economy. In her view, other potential detrimental effects resulting from a merger should be accounted for to assess efficiencies in a holistic manner. Reed J.'s interpretation certainly appears reasonable and intuitive. Although economics is the foundation of competition law, sound policy-making requires far broader and comprehensive analysis. All economic tests regarding the efficiency defence have shortcomings. The best solution for Canadian competition policy must minimize these economic misgivings and maximize the utility of competing stakeholders.

B. *Superior Propane*

Superior Propane Inc. and ICG Propane Inc. ("ICG") both carried on business in the retail sale and distribution of propane and related services in Canada. Superior Propane acquired ICG on December 7, 1998. The transaction would create 16 regional monopolies where Superior Propane/ICG would have a combined market share between 95% and 100%, 32, 46 and 66 markets where combined market shares would respectively be greater than 80%, 70% and 60% (see Exhibit 1)[32]. On a national scale, a consummated Superior Propane/ICG transaction would provide the resulting entity with 70% of the Canadian propane retail market. The national account coordination services relating to the sale of propane are excluded from these figures.

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29 C.S. GOLDMAN & J.D. BODRUG, *loc. cit.*, note 18, 738.

30 See: Arnold C. HARBERGER, "Three Basic Postulates for Applied Welfare Economics: An Interpretive Essay", (1971) 9 *Journal of Economic Literature* 785.

31 S.F. ROSS, *loc. cit.*, note 8, 90.

32 David TADMOR, "Comments on the *Superior Propane* Case", (Winter 2001) 20(4) *Can. Comp. Rec.* 77, 78.

The Commissioner of Competition contested the Superior Propane/ICG transaction on the basis that it would substantially lessen competition. The Competition Tribunal agreed with this argument but concluded that the efficiency defence saved the merger – efficiency gains offset and exceeded the effects of the lessening of competition. The Commissioner of Competition appealed the decision to the FCA and argued that the Tribunal incorrectly applied section 96 of the *Competition Act*. The Court agreed and opined that the Tribunal erred in law since it uniquely equated section 96 to the total surplus standard, and remanded the case to the Tribunal with instruction to use the balancing weights approach. The Tribunal again decided that the efficiency defence saved the otherwise anti-competitive merger. The FCA affirmed this decision on January 31, 2003.

The debate between the best applicable economic test to the efficiency defence is fervent and ongoing in Canadian competition law. Of course, this debate would not exist "… if perfect information regarding individuals' dollar gains and losses, social marginal utilities of income and the socially optimal method of aggregation were available, and if the objective were to allow welfare-increasing mergers and not to allow welfare-decreasing ones"[33]. The total surplus, balancing weights, and price standards will now be discussed to quantify costs and benefits relating to the efficiency defence.

1. Total Surplus Standard

The total surplus standard is a merger specific application of the "Potential Pareto Improvement Criterion" in economics. At its basic level, the standard is satisfied where aggregate gains exceed aggregate losses and gainers can theoretically compensate losers with money left to spare[34]. The gains further to this approach are the garnered efficiencies and the loss is the deadweight loss of wealth to the economy resulting from a transaction[35]. The total surplus standard is premised on a neutral redistribution effect where wealth transfers from consumers to producers and vice versa are deemed neutral. The standard was encompassed in the *Merger*

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33 Peter G.C. TOWNLEY, "Efficiency Standards: They Also Serve who Sit and Weigh(t)", (2002-2003) 21(2) *Can. Comp. Rec.* 115, 116.

34 *Id.*

35 *FCA 2003 Decision*, *supra* note 3 at para. 13.

Enforcement Guidelines[36] ("MEGs") at the time *Superior Propane* was decided. But the status and role of these guidelines has been questioned widely as the Commissioner of Competition did not apply them to interpret sections 92 and 96 of the *Competition Act*[37]. The Competition Bureau has since published new draft guidelines[38]. McFetridge argues that the Commissioner of Competition was opposed to the total surplus standard in *Superior Propane* because he believed firms could easily meet its requirements (i.e. the neutrality of money transfers)[39].

In applying the total surplus standard, the Competition Tribunal estimated that annual savings and deadweight loss from the Superior Propane/ICG transaction were $29.2 million and $3 million per year for the next ten years. Cost savings would be realized in field operations, corporate centers, and customer support[40]. The Tribunal also considered the qualitative effects of reduced competition. ICG had pricing arrangements and services that other propane providers did not have, including Superior Propane. The consummated Superior Propane/ICG transaction would thus eliminate or significantly reduce the agreements ICG had entered into prior to the transaction. These losses would not exceed $6 million per year, and totaled $9 million annually with the deadweight loss. It was thus argued that the impugned transaction created $20.2 million annually of efficiencies in the Canadian economy for the next ten years[41]. The FCA concluded, correctly in this paper's view, that the total surplus standard was an inappropriate test for the

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36 COMPETITION BUREAU, *Merger Enforcement Guidelines*, March 1991, online: [http://strategis.ic.gc.ca/pics/ct/meg_full.pdf] (date accessed: 13 November 2004).

37 J.S. TYHURST, *loc. cit.*, note 26, 8; Milos BARUTCISKI & Brian A. FACEY, "Superior Propane: an Overview of the First Efficiency Case", (2000) 20(2) *Can. Comp. Rec.* 36, 41; see also: Jason L. GUDOFSKY & Patrick GAY, "Long Live the Merger Enforcement Guidelines?: A Review of the Superior Propane Decision", (2000) 20(2) *Can. Comp. Rec.* 46.

38 Anthony F. BALDANZA and Huy A. DO, "Will Bureau Challenge Mergers That Substantially Lessen Competition?", (July 9, 2004) 24, No. 10 *The Lawyers Weekly*, online: QL (GDB).

39 D. McFETRIDGE, *loc. cit.*, note 6, 47.

40 M. BARUTCISKI & B.A. FACEY, *loc. cit.*, note 37, 38.

41 *FCA 2003 Decision*, *supra* note 3 at para. 15.

efficiency defence because it only scrutinized the effects of an anti-competitive transaction against the efficiencies it created[42]. The standard is overly narrow and does not give effect to the purpose clause of the *Competition Act*. The FCA ultimately favored the balancing weights approach to weight the anti-competitive effects of a transaction[43]. This approach was adjudged to give further effect to the purpose clause[44].

The Competition Tribunal has noted that if the Commissioner of Competition had provided proper evidence, the Superior Propane/ICG transaction might not have been approved further to the total surplus standard[45]. In fact, many competition law scholars argue that the total surplus standard was incorrectly applied in *Superior Propane* and is "widely misunderstood"[46]. Mathewson and Winter argue that the efficiency defence would not have been accepted had the standard been correctly applied[47]. McFetridge, a supporter of the total surplus standard, notes, "it is *highly* unlikely that mergers either to monopoly or to dominance could pass a *properly-applied* total surplus test"[48]. Sanderson similarly argues that if the Commissioner of Competition had applied the standard as prescribed in the *Merger Enforcement Guidelines*, the Superior Propane/ICG transaction would not have been approved[49]. She argues in favour of the neutrality of money assumption because valuing who is more deserving of any one dollar is extremely difficult[50]. However, this paper argues that this very assumption is counterintuitive and problematic and thus, a properly applied total surplus standard remains fundamentally flawed. It ignores distributive effects in the merger review analysis, and transfers of wealth from consumers to producers appear intuitively inequitable. Reed J. similarly ques-

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42 *FCA 2001 Decision*, *supra* note 3 at para. 159.

43 This approach was advocated by Professor Peter Townley.

44 *FCA 2001 Decision*, *supra* note 3 at para. 161.

45 *Tribunal 2000 Decision*, *supra* note 3 at para. 169.

46 Margaret SANDERSON, "Competition Tribunal's Redetermination Decision in *Superior Propane*: Continued Lessons on the Value of the Total Surplus Standard", (2002) 21(1) *Can. Comp. Rec.* 1.

47 F. MATHEWSON & R.A. WINTER, *loc. cit.*, note 8.

48 D. McFETRIDGE, *loc. cit.*, note 6, 55. (Emphasis added).

49 M. SANDERSON, *loc. cit.*, note 46, 5.

50 *Id.*, 4.

tioned the validity of welfare economics' fundamental assumption in *Hillsdown*.

The Superior Propane/ICG transaction was forecasted to increase the price of propane in Canada by 8%. Consumers would be harmed by paying higher prices for the same product, and would transfer greater wealth to the new entity to the benefit of its shareholders, who are themselves more wealthy than the Canadian average[51]. It could be argued that the Canadian economy benefits from efficiencies and consumers should be willing to pay for this, but a higher price should mean consumers are obtaining greater value, which was not the case in the Superior Propane/ICG transaction. In fact, certain consumers lost services and product offerings available to them as a result of the propane transaction. Finding a way to encourage efficiency promoting behavior and maximizing the utility of affected stakeholders should be, in this paper's view, the analytical framework of the efficiency defence. Navigating these troubled waters is clearly not an easy task.

This paper argues that the efficiency defence disproportionately favors producers to the detriment of consumers. Cost savings from mergers in tandem with high product costs are inimical to consumer protection for a number of reasons. First, efficiencies generally result from mergers and acquisitions (M&A) and these efficiencies should trickle-down to the Canadian economy. Consumers nevertheless do not fully benefit from a more robust economy because they must generally pay more for the same products after a transaction is consummated[52]. Second, merger law in Canada can make firms more internationally competitive if these firms can enter into transactions and benefit from efficiencies, all the while being *ex ante* precluded from proceeding with a transaction where product prices are forecasted to increase. Third, transferring wealth from less affluent consumers to richer producers is difficult to justify politically and is counterintuitive. The neutrality of money assumption may indeed be founded in economics, but is inconsistent with consumer protection and public-policy more generally.

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51 Data will be analyzed later.

52 Ross in fact notes that most Canadians do not believe in any sort of trickle-down effect that will ultimately benefit them: S.F. ROSS, *loc. cit.*, note 8, 92.

The total surplus standard helps garner efficiencies in the Canadian economy (assuming the efficiencies remain in Canada) – the net difference between the resulting cost savings and deadweight loss means the Canadian economy is ultimately stronger. But it is this paper's argument that the Canadian economy can be stronger through less extreme measurement of efficiencies that accounts for distributive considerations.

2. Balancing Weights Approach

In remanding the propane case to the Competition Tribunal, the FCA instructed the Tribunal to use the balancing weights approach on the basis that it is more reflective of the objectives found in the purpose clause of the *Competition Act*. The Court assessed the following merger effects: deadweight loss, interdependent and coordinated behaviour of competitors, service quality and programs, regional effects, interrelated markets, loss of potential dynamic efficiency gains, monopoly effects, and the impact on small and medium-sized enterprises[53]. The Court explains the approach as follows:

> [T]*he Tribunal …* [must] *weigh the effects of the merger on consumers against the effects of the merger on the shareholders of the merged entity. This involves a two-step process. First, the Tribunal must determine the relative weights to be assigned to producer gains and consumer losses, to equate them, or to make the wealth transfer neutral in effect. Second, the Tribunal must engage itself in a value judgment process to decide whether the assigned weights are reasonable in light of societal interests, namely, any disparity between the incomes of the relevant consumers and shareholders of the merged entity.*

In applying the balancing weights approach, the Competition Tribunal assessed the wealth transfer from consumers to shareholders resulting from the Superior Propane/ICG transaction – it was calculated to be some $40.5 million per year. The Commissioner of Competition argued for a consumer surplus standard. He argued that the $40.5 million should be added to the $6 million deadweight loss to the economy, totaling an annual $46.5 million[54]. The wealth transfer would thus exceed the merger-generated efficiencies ($29.2 million annually) by $17.3 million, and it is this rea-

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53 *FCA 2003 Decision*, *supra* note 3 at para. 21.

54 *Id.* at para. 22.

son that the Commissioner of Competition contended the transaction should not be approved. The Competition Tribunal rejected the consumer surplus standard because the $40.5 million wealth transfer is not completely socially adverse but rather has some neutral or positive effects. The Tribunal concluded that only detrimental wealth transfers should be used in assessing anti-competitive effects – this is known as the socially adverse effects approach[55] – and noted that these effects amounted to $2.6 million per year. The total negative wealth transfer from the Superior Propane/ICG transaction totaled $8.6 million per year (this included the $6 million deadweight loss), which is a far cry from the $29.2 million of annual cost savings. The Tribunal therefore approved the impugned transaction further to the efficiency defence and the FCA affirmed this judgment.

The balancing weights approach addresses distributive considerations in its assessment of a transaction's anti-competitive effects. The approach analyzes the wealth transfer from consumers to shareholders and then looks at the context of the transaction to determine whether the interests of the former should be attributed greater importance than the latter[56]. The evidence provided by Professor Townley does not indicate how the approach's reasonableness ought to be specified. He mentions that economics does not help in establishing the boundaries of reasonableness and expounding these boundaries falls under the prerogative of the public policy process[57]. The balancing weights approach in *Superior Propane* conferred more weight to the interests of low income households than to those of the resulting entity and its shareholders – these interests alone, however, were not sufficiently large to bar the transaction[58]. Indeed, the interests of personal and business consumers were determined equal to those of shareholders. This paper argues that it is also unfair for medium and high earning households, in addition to business consumers, to pay 8% more for propane because these consumers will not obtain any greater value from higher propane prices, nor will they benefit from the transaction's efficiencies.

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55 *Id.* at para. 23.

56 *Id.* at para. 25.

57 D. McFETRIDGE, *loc. cit.*, note 6, 49.

58 See: Robert H. LANDE, "On the Use of Distributional Weights in Social Cost-Benefit Analysis", (1978) 86 *Journal of Political Economy* 587.

It is this paper's view that the balancing weights approach does not strike a commensurate balance between the interests of consumers and producers in light of the *Competition Act*'s purpose clause. The approach is essentially a zero-sum game where consumer and shareholder interests oppose one another and the quantitative weight of their interests is too arbitrary a standard for competition law – but this result need not necessarily be so. The business community requires more stability and predictability in the merger review process.

The balancing weights test is undoubtedly a step forward from the total surplus standard in that it is more equitable. The test nevertheless has serious application difficulties "… and, indeed, is no longer advocated by the Commissioner [of Competition] … who was its sole champion"[59]. In principle, it addresses distributive concerns and attempts to strike a balance between the income disparity of consumers and shareholders. This paper argues that the balancing weights approach does not nearly go far enough in protecting consumer interests – propane prices in Canada again increased after the Superior Propane/ICG transaction. The impugned merger also created 16 mergers-to-monopoly in regional markets, and the merged entity's market shares would range between 60 to 80% in 146 other local markets[60].

The efficiency defence does not only allow cost savings but also provides for the ability of firms to raise product prices. A merged entity thus benefits in two ways per the efficiency defence: (1) by cutting costs, and (2) increasing revenues through higher prices. The first is logical and furthers the goals of competition policy, but the latter does not and contradicts its purpose and objectives. A firm that obtains greater market power subsequent to a merger or acquisition often has the ability to increase prices. Higher prices can in turn price lower income consumers out of the market. It is for this reason that the efficiency defence amounts to a form of "reversed robinhoodism" because it unduly prefers the interests of producers and shareholders to those of consumers. The majority of Canadians undoubtedly act as consumers in society and not as shareholders and empirical evidence, to be discussed later, confirms this fact. The efficiency defence thus amounts to the tyranny of the minority.

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59 D. McFETRIDGE, *loc. cit.*, note 6, 45.

60 D. TADMOR, *loc. cit.*, note 32, 78.

3. Price Standard

"A [p]rice [s]tandard disallows any merger that would diminish the well-being (utility) of consumers regardless of the magnitude of gains to producers. This standard involves arbitrarily imputing zero distributional weight to producers relative to consumers"[61]. This standard has intuitive benefits for sellers and buyers and is presently in use in the US. It essentially attempts to find a commensurate balance between the rights of consumers and producers – firms can achieve cost savings but cannot increase product prices. Townley argues that a price standard unambiguously improves the well-being of Canadians, whereas the total surplus and balancing weights approaches do not[62]. The approach is predictable which is essential for an effective merger review process.[63] It is far easier to litigate a price standard case because less information is required for its application than a balancing weight or total surplus standard. Measurements of wealth transfers from sellers to buyers are not necessary which avoids the assessment of redistributive effects and the complex ensuing issues[64]. Furthermore, a price standard does not lead to mergers benefiting foreign producers to the detriment of the Canadian consumers, unlike the total surplus and balancing weights approaches[65].

Like the total surplus and balancing weights approaches, a price standard is not perfect. Monitoring costs are necessary to ensure compliance *ex post* and these costs are inefficient. Similarly, monitoring price fluctuations is an intricate undertaking. Firms can increase prices for one of two reasons: (1) for sake of greater profitability, and (2) higher variable and fixed costs. The former is prohibited by a price standard but the latter is not because it constitutes a cost of doing business. Differentiating the reasons for higher prices is a difficult, time consuming and an expensive proposition, particularly because firms continually face increasing costs. Another difficulty with the price standard is the potential of politicizing the

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61 Marc DUHAMEL and Peter G.C. TOWNLEY, "From Superior Propane to Bill C-249: the Consequences of Informed Ignorance", (2004) 21(4) *Can. Comp. Rec.* 109, 110.

62 P.G.C. TOWNLEY, *loc. cit.*, note 33, 120.

63 M. BARUTCISKI & B.A. FACEY, *loc. cit.*, note 37, 39.

64 F. MATHEWSON & R.A. WINTER, *loc. cit.*, note 8, 90.

65 P.G.C. TOWNLEY, *loc. cit.*, note 33, 120.

merger review process. Wong argues that the Commissioner of Competition and in the end the Competition Tribunal will determine who gains and loses from particular transactions. He contends that barring a merger due to higher prices leads competition law and economics down a path where these disciplines can offer little guidance[66]. With respect to Wong's critique, it is difficult to understand how a price standard politicizes the merger process. If anything, a price standard de-politicizes merger reviews *ex ante*, because firms have less leeway to argue for the merits of a merger based on economic tests requiring value judgments, such as the total surplus and balancing weights approaches.

4. Competition Law and Distributional Concerns

It has been argued that competition law should only focus on efficiency because other media exist to address distributional concerns. The *Interim Report on Competition Policy (1969)* mentions "… that there exist more comprehensive and faster-working instruments, particularly the tax system and the structure of transfer payments, for accomplishing the deliberate redistribution of income and the diffusion of economic power, to whatever extent these are thought to be desirable"[67]. The Competition Tribunal states the same[68], and also mentions that if other media cannot address distributional concerns, then merger policy should indeed do so[69]. The statement regarding the more appropriate ways to achieve distributive ends is true in principle. But Ross mentions that we are concerned here with "… a specific unjust distribution of wealth caused by a specific anti-competitive merger"[70]. Similarly, it is easier to ask the legislature *ex ante* to create equitable and efficient legislation

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66 S. WONG, *loc. cit.*, note 4, 2.

67 ECONOMIC COUNCIL OF CANADA, *Interim Report on Competition Policy*, 1969, at 19 and 20 (hereinafter the "*Interim Report*").

68 "Clearly, there are more effective ways to ensure low and fair consumer prices over the economy as a whole than through a policy of maintaining and encouraging competition in Canada, but these other ways risk substantial, widespread bureaucracy and inefficiency, and reduction in economic growth and living standards, and they would not long be tolerated by Canadians": *Tribunal 2002 Decision*, *supra* note 3 at para. 204.

69 *Id.* at para. 205.

70 S.F. ROSS, *loc. cit.*, note 8, 94.

than to ask for subsequent distributive legislation[71]. The policy-making process in Canada is such that public interest groups have significant influence and may block such legislative efforts for reason of conflicting interests[72]. Also, identifying parties negatively affected by efficiency is difficult, expensive and wasteful[73].

Townley argues that taxes and transfer payments actually exacerbate distributional concerns as opposed to making them better[74]. A profitable transaction will lead certain higher-income people to pay additional taxes as they are directly benefiting from the wealth that was created. On the other hand, lower income citizens will not receive compensation, as their nominal income remains the same. The tax system does not identify low income citizens as having suffered damages from higher product prices and they will therefore not receive any tax refunds or transfer payments[75]. It is also ironic that taxes may in principle be used to compensate prejudiced consumers, but higher product prices actually make consumers pay higher taxes as well. In the province of Ontario, for example, the combined federal and provincial sales taxes are currently 15%. Consumers in *Superior Propane* therefore not only have to pay an additional 8% for propane, but also have to pay 15% of the 8% increase as well which amounts to a 9.20% total price increase to consumers. If consumers were actually compensated via tax relief or otherwise, they would therefore be subsidizing themselves which adds further insult to injury.

The Competition Tribunal recommends the creation of a price review board to address distributive concerns for mergers resulting in cost savings and product price increases. This is *ex post* merger regulation and is seen as bureaucratic and inefficient to the Canadian economy in the competition law literature. Nevertheless, a price review board could be a sound mechanism to ensure that undue price increases do not occur after a transaction has closed. The cost to companies and to the government for a price review

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71 *Id.*, 92.

72 *Id.* See: Fred THOMPSON and William T. STANBURY, *The Political Economy of Interest Groups in the Legislative Process in Canada*, Montreal, Institute of Research on Public Policy, 1979.

73 S.F. ROSS, *loc. cit.*, note 8, 92.

74 P.G.C. TOWNLEY, *loc. cit.*, note 33, 123.

75 *Id.*, 124.

board might not be significant, particularly in light of cost savings in very large transactions. Presumably, an *ad hoc* price review board could be convened when needed. *Ex post* regulation should nevertheless generally be avoided for sake of efficiency.

5. *Superior Propane* as a Precedent

Superior Propane is bad law. Rothstein J.A. (as he then was), for the majority, notes that a merger-to-monopoly is not *prima facie* problematic because monopoly is a market condition and only the effects of monopoly must be analyzed to determine whether competition is substantially lessened[76]. This view does not seem justified. The Superior Propane/ICG transaction was consummated despite the fact that mergers-to monopoly were created in 16 regional markets in Canada where the merged entity would have a combined market share between 95 and 100%. But Superior Propane and ICG would have a combined market share in excess of 80%, 70%, and 60% for 32, 46 and 66 regional markets respectively[77]. If effective monopolies were created, then anti-competitive effects very likely but not always ensue from these "market conditions." In addition, the Superior Propane/ICG transaction was allowed on the basis of propane being a natural monopoly market in Canada. One firm does not generally better serve the market than competing firms do. If a natural monopoly for propane existed in Canada, economic theory tells us that all firms but one would incur losses through the competitive market structure. Competition in the propane market existed in Canada before the merger and still exists, though now minimally, in certain regional markets[78]. It is thus difficult to contemplate a general rule where a monopoly's effects do not violate competition law, exceptions notwithstanding. The *Interim Report* confirms this reasoning:

> *To many economists, the greatest objection to monopoly … is that it distorts the way scarce human and physical resources are brought together and used to meet the many demands of consumers. It leads, in other words, to inefficiency. The monopolist's prices are too high, relative to*

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76 *FCA 2003 Decision*, *supra* note 3 at para. 49.

77 D. TADMOR, *loc. cit.*, note 32, 78.

78 *Id.*, 80.

> *other prices, and because the usual adjustment machinery is not operative, they remain so.*[79]

A monopoly may not be inherently bad, but the abuse of this monopoly clearly is. It can be argued that benefits may exist from having a single supplier in a particular market. A merger-to-monopoly does not seem so bad where consumers, for example, benefit from lower prices following a merger. The problem, however, lies with future price movements. Even where a merger-to-monopoly does lower prices to consumers in the short-run, prices would inevitably rise above competitive levels in the long-run because firms can maximize profits in doing so. The dominance created from a merger-to-monopoly thus is likely to become an abuse of dominance with time. A merger-to-monopoly may achieve efficiency in certain rare instances, particularly in cases of a natural monopoly situation. But in considering the anti-competitive effects of a merger, understanding why competition is salutary and the harm resulting from an absence of competition is necessary. In *Superior Propane*, the absence of competition was *ex ante* determined to increase the price of propane by 8% in Canada. Higher prices must be ruled out in this paper's view to better protect consumers. A merger-to-duopoly seems a lot less problematic than a merger-to-monopoly, despite the possibility of collusion. Of course, multiple firms in a defined market are far more preferable. Competition, in its simplest form, leads to rivalry between firms to win the business of consumers. It can occur in a variety of ways, such as product development, higher product quality and lower prices. Vigorous competition creates innovation between competing firms to the ultimate benefit of consumers. "The consequences of this are that prices will typically be bid down to an efficient level of costs, [and] a diversity of product offerings will come on to the market that matches the heterogeneity of consumer needs and tastes …"[80]. Rothstein J.A.'s majority judgment declined to specifically answer the treatment that mergers-to-monopoly should receive in considering the efficiency defence for reason that it is already accounted for in the merger effects[81]. The Court justified its position based on a lack of evidence regarding

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79 *Interim Report*, *op. cit.*, note 67 at 6 and 7.

80 Paul A. GEROSKI, "Is Competition Policy Worth It?", September 2004, online: [http://www.competition-commission.org.uk/our_peop/members/chair_speeches/pdf/geroski_uea_140904.pdf] (date accessed: 10 December 2004) at 2 and 3.

81 See *supra* note 68.

whether additional effects other than those already analyzed result from monopolies[82].

Justice Létourneau's dissenting judgment regarding mergers-to-monopoly is well-founded, follows the objectives of competition policy and should be preferred to the majority judgment. His many questions indicate the difficulty of the subject at hand[83]. Allowing mergers-to-monopoly, in his view, violates the purpose clause because small and medium-sized enterprises will be effectively excluded from competition[84]. Similarly, the US Department of Justice and Federal Trade Commission would agree with Létourneau J.A. as the *Horizontal Merger Guidelines* mention that "[e]fficiencies almost never justify a merger to monopoly or near-monopoly"[85]. The US Supreme Court has also stated with regard to American antitrust law that "Congress was dealing with competition, which it sought to protect, and monopoly, which it sought to prevent"[86]. Again, the evidence indicates that many mergers-to-monopoly in regional markets were created from the Superior Propane/ICG transaction[87]. It seems entirely counterintuitive to accept a merger-to-monopoly situation without, for example, regional asset divestitures. Competition itself is not a goal of competition policy but is rather a means to an end – to have efficient markets that ultimately benefit consumers.

It could be argued that there were no merger-to-monopolies in *Superior Propane* because consumers had access to alternative fuels[88] and were not accordingly forced to purchase propane. However, the propane industry is marked by very high barriers to entry which further results in significant market power for propane-selling firms. Switching to an alternative source of energy is very expensive

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82 *FCA 2003 Decision*, *supra* note 3 at para. 50.

83 Russell W. LUSK, "Balancing Competition and Efficiencies – An Impossible Dream?",(2002) 21(1) *Can. Comp. Rec.* 33, 33.

84 *FCA 2001 Decision*, *supra* note 3 at para. 14 and 15.

85 US DEPARTMENT OF JUSTICE AND FEDERAL TRADE COMMISSION, *Horizontal Merger Guidelines*, April 2, 1992, revised April 8, 1997, online: [http://www.usdoj.gov/atr/public/guidelines/horiz_book/hmg1.html] (date accessed: 13 November 2004) at s. 4.

86 *FCA 2001 Decision*, *supra* note 3 at para. 16, quoting *A.E. Staley Mfg. Co.* v. *Federal Trade Comm'n*, 135 F.2d 453, 455 (7th Cir. 1943).

87 See Exhibit 1.

88 The market definition in *Superior Propane* did not take into account alternative fuels to propane.

because equipment is a sunk cost. Propane is also not a commodity in the broader sense because a seller's reputation is important, as is access to retail outlets. Furthermore, the propane market is marked by stability of demand and new entrants would therefore primarily focus their segmentation efforts on existing propane consumers. The industry is typified by long-term contractual arrangements, which is another barrier to entry. Moreover, "[i]nelastic demand and low cross-elasticity of supply supplement these steep barriers to entry. Demand for propane is relatively inelastic with respect to changes in its price"[89]. The foregoing barriers to entry make it difficult to understand the rationale underlying *Superior Propane*.

Allowing mergers to go forward due to international competition implies one very basic point – the product must face international competition. In *Superior Propane*, the international competitiveness of Superior Propane and ICG was not at issue. Indeed, the market for propane in Canada is not national, and is rather characterized by a number of regional markets. Tadmor correctly notes that the Competition Tribunal erred in calculating the deadweight loss and efficiencies of the transaction nationally and not in each regional market. An aggregation problem clearly existed because positive efficiencies in one very large market may obscure losses in smaller markets. Therefore, "[r]egional markets call for regional analyses and regional remedies if the correct economic conclusion is to be obtained"[90]. A fundamental reason behind the efficiency defence is to promote international competitiveness. This rationale was not properly contextualized in *Superior Propane*.

The total surplus and balancing weights standards cannot be correct. These two methods require a significant amount of mathematical calculations. Conducting a quantitative cost-benefit analysis is inexact and requires a plethora of assumptions, as does any type of forecasting. Accepting quantitative analysis as gospel, particularly when preferred over qualitative analysis can be oddly deceiving and provides a false sense of security[91]. All merger costs and benefits cannot be predicted with certainty. To make the merger review process more certain, the efficiency defence must be interpreted through an economic test where quantitative uncertainty is

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89 D. TADMOR, *loc. cit.*, note 32, 78.

90 *Id.*, 80.

91 R.W. LUSK, *loc. cit.*, note 83, 42.

minimized. Canadian competition policy aims to help Canadian firms become internationally competitive, but promoting competition to ensure consumer protection through low prices is also one of the *Competition Act*'s important objectives[92].

The status quo efficiency defence is unjustifiable. A proper policy-oriented analysis will thus be about the distribution of costs and benefits and much of the discussion will be about who wins and who loses. It is this paper's view that the neutrality of money assumption is unfair. Government regulation of certain business areas effectively means the one-dollar, one-vote regime of private markets must be replaced with the one-person, one-vote principle; democracy[93]. It is intuitive that lower income brackets season price increases less well than higher income brackets. The efficiency defence undoubtedly benefits corporations and shareholders because as mentioned, they "double dip" by benefiting from efficiencies in two ways: (1) cost savings, and (2) higher revenues by raising product prices. The former are justified because economies of scale and critical mass are necessary to compete internationally and to make the Canadian economy more prosperous. But the latter prejudices consumers. It is inequitable for firms and their shareholders to benefit from all the benefits of merging but incur none of the costs. It only seems equitable that consumers should at the very least benefit from stable prices, but lower prices would obviously be preferable. The legislative history indicates that greater competition and efficiency do not operate in a vacuum, but were rather meant to provide consumers with better quality, more extensive product selection and most importantly, lower product prices[94]. These touted benefits from the efficiency defence and *Competition Act* have yet to materialize.

Legislative reform of the efficiency defence is required that strikes a commensurate balance between the interests of producers, consumers and the Canadian economy. Legislative alternatives will now be surveyed.

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92 *FCA 2003 Decision*, *supra* note 3 at paras. 71-76.

93 S.F. ROSS, *loc. cit.*, note 8, 90.

94 *Tribunal 2002 Decision*, *supra* note 3 at paras. 62 and 67.

II. Legislative Reform

Holsten notes that the *Superior Propane* decision is tortured and important legislative reform should not arise from a single merger case[95]. This paper argues that this "tortured" decision demonstrates manifest problems with the efficiency defence and warrants legislative change to better safeguard the future and prosperity of all Canadian consumers, all the while promoting market efficiency. Encouraging dialogue between the courts and Parliament buttresses the policy-making process and courts have encouraged such dialogue[96]. It is in this light that former Commissioner of Competition von Finckenstein asserted that the "… Bureau has decided that it will not appeal the Federal Court of Appeal's latest decision in the Propane case … After extensive litigation, it is clear that further litigation would not have clarified the efficiency defence. Only a legislative solution is workable"[97]. A legislative amendment will help prioritize the conflicting objectives of the purpose clause of the *Competition Act* and unequivocally clarify *Superior Propane*'s confusion and widespread rebuke with regard to the efficiency defence.

On a comparative note, the US has integrated the analysis of efficiencies in its merger review process in the late 1990's, insofar as consumer welfare remains unharmed. The European Union (the "EU") on the other hand adopted merger guidelines in 2004 that incorporate efficiencies in its review process and protects consumer interests[98]. Despite differing competition law regimes in Canada, the

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95 R. Jay HOLSTEN, "One Step Forward, Two Steps Back: Superior Propane, Bill C-249 and the Future of Efficiencies in Canadian Merger Review", (2003) 21(3) *Can. Comp. Rec.* 1, 5.

96 See: *Hunter* v. *Southam*, [1984] 2 S.C.R. 145, 169.

97 Speaking Notes for Konrad von Finckenstein, Commissioner of Competition, Bill C-249 *An Act to amend the Competition Act*, Standing Committee on Industry, Science and Technology, 31 March 2003, online: [http://strategis.ic.gc.ca/pics/ct/ct02543e.pdf] (date accessed: 1 November 2004) at 3. J.S. TYHURST, *loc. cit.*, note 26, 12, similarly notes that Parliament is the ultimate arbiter in the efficiency defence debate where as the Competition Tribunal and courts are not.

98 "Speaking Notes for Sheridan Scott Commissioner of Competition"– Bill C-249 before the Standing Senate Committee on Banking, Trade and Commerce, 12 May 2004, online: [http://competition.ic.gc.ca/epic/internet/incb-bc.nsf/en/ct02846e.html] (date accessed: 31 October 2004) at 4 (hereinafter "*Speaking Notes for Sheridan Scott 2*"). Of course, The *Interim Report* notes that comparative antitrust law does not account for specificities of the Canadian market and we should be wary of differences in country-specific economic environments.

US and EU, *Superior Propane* and its application of the efficiency defence is far removed from the goals of competition law and section 96 of the *Competition Act* should be amended. Two important legislative alternatives are important. First, repealing the efficiency defence and considering efficiencies as one factor among many in the merger review process. *An Act to Amend the Competition Act*[99] was reflective of this approach and was advocated by the Competition Bureau. Second, amending the efficiency defence such that the Bureau and Tribunal can approve otherwise anti-competitive mergers where merging firms gain efficiencies and are *ex ante* forecasted to keep product prices constant. This paper recommends the latter proposal, which it called the "price maintenance standard."

A. Bill C-249

Bill C-249 was introduced as a private member's bill in the spring of 2003[100]. This bill amended subsection 96(1) of the *Competition Act*[101] and effectively repealed the efficiency defence where

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The *Interim Report*, *op. cit.*, note 67 at 48, notes particular caution with regard to US antitrust policy which was initially similar to that of Canada, but there has been significant divergence since then which is: "… partly a reflection of certain rather deep-seated differences between the two countries and the smaller size and greater openness and world-trade orientation of the Canadian economy. Perhaps the most important implication of the latter difference is that the Canadian economy is less able than its US counterpart to afford a competition policy that, on occasion, may be prepared to sacrifice economic efficiency for other ends, such as the preservation of small business."

99 HOUSE OF COMMONS, *Bill C-249, An Act to Amend the Competition Act,* 3rd Session, 37th Parliament, 52 Elizabeth II 2004, online: [http://www.parl.gc.ca/47/3/parlbus/chambus/house/bills/private/C-249/C-249_3/C-249_cover-E.html] (date accessed: 14 November 2004) (hereinafter "Bill C-249").

100 Jack QUINN and Michael PIASKOSKI, "Draft Legislation Seeks to Limit the Role of Efficiencies in Mergers", 2003, online: [http://www.blakes.com/english/publications/focus/article.asp?A_ID=320&DB=BlakesReport] (date accessed: 31 November 2004).

101 See: Bill C-249, *supra* note 99. The current subsection 96(1) would be replaced with the following:

> **96.** (1) *In determining, for the purposes of section 92, whether or not a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially, the Tribunal may, together with the factors that may be considered by the Tribunal under section 93, have regard to whether the merger or proposed merger has brought about or is likely to bring about gains in efficiency that will provide benefits to consumers, including competitive prices or product choices, and that would not likely be attained in the absence of the merger or proposed merger.*

merger-generated efficiencies would no longer constitute a full and plenary defence to effects from an otherwise anti-competitive merger, but would rather be one factor among many in determining whether a merger is approved. The new merger review focus would have shifted to "… the likelihood that the relevant markets would remain competitive and consequently bring the many positive results that can flow from competitive markets – choice, competitive prices, product and service innovations and investment"[102]. The private nature of Bill C-249 exempted it from the extensive policy review process that a public bill would have generated[103]. The bill passed first, second and third readings in the House of Commons in Fall 2003, and underwent review before the Standing Senate Committee on Banking, Trade and Commerce but died on the order of paper on November 12, 2003 because Parliament was prorogued. Nevertheless, Bill C-249 was reintroduced in the last legislative session and was deemed to pass first through third readings in the House of Commons and first reading in the Senate but again, Parliament was prorogued. Developments in this area should be followed closely. Bill C-249 was a step in the right direction towards providing consumers with a greater voice in the merger review process but was lacking in several areas that leads this paper to reject it.

Bill C-249 was excessive and an amendment should be preferred because the efficiency defence has the real potential of promoting efficiency in the Canadian economy. Moreover, the Bill conferred the Competition Bureau and ultimately the Competition Tribunal with excessive leeway in considering efficiencies as one relevant factor among many. This approach does not provide sufficient assurances that product price will *ex ante* remain constant. The new subsection 96(1) would have stated that "the Tribunal *may*" consider whether consumers reap benefits from a merger or proposed merger. The Tribunal can therefore choose to ignore efficiencies, but if it considers them, must account for consumer interests. This paper prefers stronger language, such as:

> *The Tribunal* must *together with the factors that may be considered by the Tribunal under section 93, assess whether the merger or proposed merger will likely provide benefits to consumers, most importantly including stable or preferably lower product prices, equivalent or more extensive services, equivalent or more extensive product choices, and*

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102 *Speaking Notes for Sheridan Scott 2*, *op. cit.*, note 98 at 3.

103 M. DUHAMEL and P.G.C. TOWNLEY, *loc. cit.*, note 61, 117.

equivalent or better product quality. Any merger-to-monopoly is strictly prohibited, exceptional circumstances notwithstanding.

The Competition Tribunal is highly specialized and civil courts must defer to this expertise. Providing the Tribunal with further discretion in the event of a contested merger makes its decision more difficult to overturn on appeal which is undesirable. A legislative proposal having clearly defined rules and providing relatively little discretion to the Tribunal should be preferred, and Bill C-249 fails to meet this mold.

Bill C-249 has not been well received in the competition law literature both substantively and with regard to its public consultation process[104]. It is this paper's view that the merger review process in Canada must encompass a standard based on the twin concepts of consumer protection and efficiency. An efficiency defence having a standard where post-merger prices either drop or remain constant should be preferred for two main reasons. First, deadweight loss would be avoided and consumers would not be priced out of the market. Second, merging firms could garner efficiencies despite their *ex ante* inability to raise price for profitability reasons.

B. Price Maintenance Standard

Duhamel and Townley state that a broad standard for applying an economic test is unacceptable. Whatever standard is accepted must be sufficiently flexible to adapt and change to case-specific evidence[105]. This position is intuitive. Moreover, a proper standard must allow consumers to share in efficiencies garnered from the merger review process, which leads this paper to propose an *ex ante* price maintenance standard. Firms should be able to merge for efficiency reasons because this ultimately makes the Canadian economy stronger. However, firms should not enjoy a two-fold benefit of cost savings and price increases.

Adopting a price maintenance standard is a reasonable solution that meets the needs of competing stakeholders and promotes efficiency in the Canadian economy. The Superior Propane/ICG trans-

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104 See: R.J. HOLSTEN, *loc. cit.*, note 95; M. DUHAMEL and P.G.C. TOWNLEY, *loc. cit.*, note 61.

105 M. DUHAMEL and P.G.C. TOWNLEY, *loc. cit.*, note 61, 115.

action would not have been approved under the price maintenance standard because propane prices were *ex ante* forecasted to increase by 8% nationwide. Consumers would benefit from this initiative and "reversed robinhoodism" would end in Canadian competition law. As was mentioned, a number of difficulties exist with a regular price standard which explains the necessity of certain modifications – the price maintenance standard indeed is a price standard variant. The other economic tests, such as the total surplus and balancing weights approaches are extremely difficult to apply and create uncertainty and corollary costs, such as the chilling effect on potential mergers and increasing costs of finding appropriate merger partners. Additional predictability leads to numerous cost savings, which is market efficient[106]. The total surplus standard ignores distributive concerns altogether. The balancing weights approach attempts to ascribe varying importance to differing income distributions which creates uncertainty in the business world about which mergers are acceptable and which are not. An *ex ante* price maintenance standard is easy to understand. "It says that a society is not at its optimal position if there exists at least one change which would make someone in that society better off and no one in it worse off"[107].

Tadmor's states that "[s]adly, in practice, any attempt to quantify net gains and losses derived from wealth transfers would be an exercise in futility, which is precisely my point: a legal standard, desirable in theory as it may be, that cannot possibly be proven in a court of law nor properly calculated, is not a useful standard"[108]. A price maintenance standard is intuitive and can be more readily applied than other standards. During the merger review process, *ex ante* forecasts regarding product prices will be conducted, and transactions that will likely lead to higher prices will not be approved. The price maintenance standard is admittedly not perfect, just as no other standard is perfect, but is better relative to competing standards.

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106 Alan A. FISHER and Robert H. LANDE, "Efficiency Considerations in Merger Enforcement", 71 *Cal. L. Rev.* 1580, 1655 (1983).

107 Guido CALABRESI, "The Pointlessness of Pareto: Carrying Coase Further", 100 *Yale L.J.* 1211, 1215 (1991).

108 D. TADMOR, *loc. cit.*, note 32, 84.

A price maintenance standard would exist to *ex ante* prevent post-merger price increases and would protect consumers far more than the current efficiency defence. On the one hand, passing on benefits from efficiencies to consumers will help ensure a post-merger competitive market and thus proscribe merger-to-monopoly situations. "… [G]enerally speaking – only (actual or potential) competition can guaranty that savings generated through a merger will in fact be passed on to consumers"[109]. On the other hand, a price standard "… limits the calculations to those savings and other efficiencies resulting from a merger that are in fact expected to pass on to consumers – a more manageable approach indeed"[110]. Mergers are very time sensitive, as corporate action is often carefully orchestrated to capital market fluctuations. Any adopted standard must be expeditious or else a chilling effect on mergers will occur[111]. A price maintenance standard where a portion of savings is passed on to consumers, reduces the number of economic calculations and thereby quickens the merger review process. Similarly, a price standard that does not approve mergers or acquisitions where firms plan to increase prices simplifies the required economic analysis. This is where the analysis ends under a regular price standard. But case specificities must be accounted for as well and another analytical step is necessary. Firms should *ex ante* be able to introduce evidence to the Competition Bureau and Competition Tribunal if the merger becomes litigious that would allow them to raise prices. The following factors should be relevant but are not exhaustive: (1) the amounts of efficiencies and deadweight loss created by the transaction; (2) who benefits from the generated efficiencies; (3) whether the transaction is necessary to compete on the global scene, and (4) whether prices must be raised due to forecasted cost structures. These factors would have to be interpreted restrictively, failure upon which the price maintenance standard would be emptied of meaning.

As noted, proper monitoring is key for a price standard enforcement – this is *ex post* regulation. But an *ex post* approach is laden with administrative costs that must be avoided for efficiency purposes. The merger review process in Canada, the US and EU is primarily *ex ante* in nature for efficiency purposes. The price maintenance

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109 *Id.*, 88.

110 *Id.*

111 R.W. LUSK, *loc. cit.*, note 83, 37.

standard that this paper proposes is *ex ante* for the most part but has *ex post* underpinnings. The Commissioner of Competition can currently review mergers for up to three years after they occur and this paper sees no reason to derogate from this review period. Monitoring programs are not new in Canada. The Competition Bureau has availed itself of these to stay abreast of post-merger developments in cases where market shares have been high and where section 93 factors are negatively weighed[112]. The Bureau, for example, rigorously monitored the Molson and Carling O'Keefe merger where it received quarterly reports on a number of matters, such as capital expenditures and cost savings[113]. The price maintenance standard could provide for the sporadic audit of prices on an ongoing basis, but adopting the monitoring style of the Federal Trade Commission "in appropriate but limited circumstances" seems wise and necessary[114]. Auditing costs should be assumed by merged entities and will constitute one of the costs of the "costs of making transactions in a market economy", as Calabresi puts it, which will be incorporated into the efficiencies story in the merger review process[115]. A slight reduction in benefits from efficiencies will evidently occur, but this would not be unduly significant in light of promoting efficiency and consumer protection. *Ex post* regulation pursuant to the price maintenance should, again, be used in exceptional circumstances, and the lion's share of the analysis must be to regulate mergers *ex ante*. Nevertheless, the Competition Bureau must have some sanctioning power for egregious cases. In the most exceptional cases, such as a 50% post-merger price increase, the Bureau could use a "hold-separate" order or "crown jewel" divestiture[116].

It can be argued that the price maintenance standard is similar to the balancing weights approach. Whereas the two standards are similar, they differ in an important way. The balancing weights approach considers distributive considerations, but nonetheless *ex*

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112 M. SANDERSON, *loc. cit.*, note 7, 638.

113 See: CONSUMER AND CORPORATE AFFAIRS CANADA, News Release NR-10256, Proposed merger of the brewing operations of Molson and Carling O'Keefe, July 6, 1989.

114 FEDERAL TRADE COMMISSION, "Anticipating the 21st Century: Competition Policy in the New High-Tech, Global Marketplace", 1996, Staff Report 25, online: [http://www.ftc.gov/opp/global/report/gc_v1.pdf] (date accessed: 27 October 2004) at 42.

115 G. CALABRESI, *loc. cit.*, note 107, 1211 and 1212.

116 *Id.*

ante allows for price increases. The price maintenance standard, on the other hand, results in a compromise between producers and consumers – the first can continue to enjoy the benefits of efficiencies and the latter can keep purchasing the same products at constant or lower prices, exceptions notwithstanding.

The price maintenance standard will reduce the benefits that merger-seeking firms would achieve through the merger process; transactions that would likely lead to higher prices would not be approved. It can be argued that the price maintenance standard will therefore have a chilling effect on welfare enhancing mergers in Canada and reduce the creation of efficiency in the economy. But the Competition Chairman of the United Kingdom, Paul Geroski, noted in his capacity of economist that measuring deterrence from strong merger rules is very difficult[117]. It will thus be intricate to quantitatively measure the effect of the price maintenance rule. But strictly speaking from a business perspective, it is this paper's position that the chilling effect of the price maintenance standard will be minimal. Indeed, it is rational for firms to make strategic corporate moves that increase firm value and provides greater wealth to shareholders. Cost savings and access to new markets will outweigh *ex ante* regulatory restrictions on price increases. Furthermore, the efficiency defence further to the balancing weights approach leads to significant uncertainty in the business world. Counsel and economists must now make value judgments where the losses of lower income people, in certain circumstances, are attributed more importance than those of higher income people. The economics behind this will differ among economists and the uncertainty on firms contemplating strategic corporate alliances is immediately apparent.

The price maintenance standard is far simpler to apply than the current state of law in Canada. Geroski appropriately notes that significant cost savings arise in the M&A process when parties understand clearly defined rules, issues and analytical methodologies. "In this situation, the knowledge of the 'rules of the game' enables the parties to focus on the arguments that really matter, and make their points economically and efficiently"[118]. Further certainty through the price maintenance standard will therefore reduce transaction costs and offset costs arising from merger chilling effects. It

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117 P.A. GEROSKI, *loc. cit.*, note 80, 8.

118 *Id.*, 9.

is more opportune for counsel to advise companies on the type of actions they cannot undertake, as opposed to defending them before regulatory authorities. This must be the goal of the Competition Bureau for sake of preserving scarce resources. The price maintenance standard, in its own right, creates efficiency in the Canadian economy and protects consumers simultaneously.

The price maintenance standard is also justified because of Canadian demographics and the exporting of efficiencies from the Canadian economy to foreign nation-states.

1. Canadian Demographics

Efficiencies in competition law are essential for nation-state wealth maximization and often help firms become more profitable in the long-term[119]. Higher profits benefit shareholders because of increased future cash flows which increase stock price. The price maintenance standard is reflective of distributive concerns in society because it protects Canadian consumers while still allowing firms to garner efficiencies and earn handsome returns for their shareholders. The standard is clearly a compromise between consumer and producer interests. Unlike the balancing weights approach, the price maintenance standard makes a policy-choice from the very beginning, and does not require subsequent value judgments in its application. The demographic segmentation of shareholders in Canada is important to analyze for the price maintenance standard.

Exhibit 2 on the "Proportion of household wealth in shares" demonstrates that 18.9% of household wealth in Canada was invested in shares of publicly traded companies in the year 2000. The number of Canadians owning stock is actually far less than 18.9% as higher income segments invest in stock significantly more than lower income brackets do. Exhibit 3 on the "Pattern of share holdings across selected G7 countries" indicates that 6.6% of the German population accounts for 25.9% of stock holdings, 8.5-4%

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[119] This said, the mergers or acquisitions of public companies generally lead to decreased stock price in the short-term because shareholders believe the bidding company bid too high for the target – also known as the winner's curse. See: Michael R. BAYE, *Managerial Economics and Business Strategy*, 4th ed., Toronto, McGraw Hill, 2003, at 455 and 456.

for France, 12.6%-31.7% for Italy, 25%-37.9% for the United Kingdom, and 8.6%-56.6% for the United States. Similar figures exist in Canada. The vast majority of Canadians thus operate not as shareholders, but as consumers. Higher post-merger prices accordingly lead to wealth transfers from consumers to producers which is intuitively unfair.

Persons in low to average income brackets form the majority of Canadian society and allowing firms to merge for efficiency reasons is a form of subsidizing wealthier persons. A merger that substantially lessens competition is therefore likely to directly benefit a minority of Canadians, notwithstanding the wealth created in the Canadian economy. When enacting the *Competition Act*, Parliament focused on efficiency and the international competitiveness of firms. The legislative history indicates that consumer protection was to ensue from these objectives[120]. The aforementioned demographic data confirm Ross' assertion that "Parliament would not enact an efficiency defence indifferent to a transfer of wealth from voters who primarily see themselves as consumers, a class that constitutes the majority, to voters who primarily see themselves as shareholders"[121]. Creating more wealth in the economy benefiting a select few is democratically untenable, despite the fact that the total wealth standard may be Kaldor-Hicks optimal[122].

Ross claims that Parliament did not intend "consumer exploitation" as a by-product of enacting the *Competition Act*'s merger provisions[123]. The 8% increase in propane prices in Canada indeed amounts to Ross' "consumer exploitation", and would have been avoided pursuant to the price maintenance standard. This standard would not have allowed the merger to proceed based on the evidentiary record. The *Competition Act* may well be referred to as one of the most advanced economically advanced laws in the world but economics alone does not constitute sound policy-making. Indeed, governments must often act in a less economically efficient manner

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120 *Tribunal 2002 Decision*, *supra* note 3 at para. 62.

121 S.F. ROSS, *loc. cit.*, note 8, 92.

122 *Id.*, 93. The "Kaldor-Hicks" criterion requires that monetary gains exceed losses and no compensation needs to be paid for those losing money. For a description of this, see more generally: G. CALABRESI, *loc. cit.*, note 107, 1221-1227.

123 S.F. ROSS, *loc. cit.*, note 8, 93. See also: Stephen F. ROSS, "Afterword- Did the Canadian Parliament Really Permit Mergers than Exploit Canadian Consumers so the World can be More Efficient", (1997) 65 *Antitrust Law Journal* 623.

to reach an equitable solution for society as a whole. The efficiency defence is thus reflective of the limitations of economics in policy-making. The fundamental assumption of welfare economics is ill-suited for public policy reasons. A dollar transfer from a consumer to producer with no aggregate change in the wealth of society is not a neutral result because a dollar lost by a poor person is more harmful than a dollar lost by a rich person[124]. Fisher seems justified in stating "[a]ny merger likely to raise prices would in effect constitute theft of some consumers' property without giving them anything in return. In a democracy, each person, wealthy or poor, has the right not to have his property stolen, no matter how poor the thieves are"[125]. The price maintenance standard avoids much of the uncertainty and problems that other economic approaches have failed to remedy. Of course, exceptional circumstances can warrant its *ex post* application.

2. International Competitiveness

During debates regarding the *Competition Act*'s enactment, the Minister of Consumer and Corporate affairs mentioned that the size of the Canadian market is small and its economy is quite open. The guide accompanying the *Competition Law Amendments*[126] indeed notes international competitiveness as the reason for the efficiency objective:

> *Canadian firms often have to compete with larger foreign rivals both at home and abroad. In these circumstances, they should not be prevented from obtaining economies of scale which improve their competitive position. An effective merger law must weigh the advantages of economic efficiency against the disadvantages of a lessening of competition.*[127]

One of the primary policy rationales behind the efficiency defence is therefore to enable Canadian corporations to reach necessary critical mass to compete internationally. Critical mass is important

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124 P.G.C. TOWNLEY, *loc. cit.*, note 33, 124.

125 Alan A. FISHER, Robert H. LANDE and Stephen F. ROSS, "Legalizing Merger to Monopoly and Higher Proces: The Canadian Competition Bureau Gets It Wrong", (Fall 2000) *Antitrust Magazine* 71.

126 MINISTER OF CONSUMER AND CORPORATE AFFAIRS, The Honourable Michel Côté, *Competition Law Amendments: A Guide* (hereinafter *Competition Law Amendments: A Guide*).

127 *Id.* at 16.

because size matters when competing internationally, and synergies can be achieved through the merger process that may not be attainable through a company's organic growth[128]. The importance of the international competitiveness objective is clear. The world has become an interconnected community at social, political, ideological and economic levels. This phenomenon is often called globalization and unprecedented trade development is its most visible indicator[129]. The efficiency defense can be seen as an instrument enabling Canadian companies to compete internationally, but this is not a justification for "… firms to increase price, save costs, and retain all the benefits for themselves"[130]. This paper's proposed price maintenance standard indeed protects consumers against price increases and makes it more difficult for firms to retain all realized benefits.

The number of cash flows crossing nation-state boundaries is exponentially increasing and much of the wealth created by efficiencies in Canada is exported to other countries. The Canadian economy does not therefore entirely benefit from merger efficiencies and the Competition Tribunal correctly recognized in *Superior Propane* that exported wealth should not be included in the effects of mergers on the Canadian economy. According to the (the "OECD"), foreign direct investment ("FDI") inflows have been far more significant than outflows in Canada from 1998 to 2001[131]. FDI for OECD countries increased heavily from 1995 to 2001[132], and Canada's share grew from 19% to 28% of its gross domestic product[133]. Foreign corporations therefore are increasingly investing in Canada which benefits the shareholders of these corporations because they are earning higher returns on investment. Price increases not only harm Canadian consumers, but wealth created from these increases is exported to other countries. Other than paying their taxes and spending financial capital in Canada, the additional wealth created in the economy will not directly benefit Canadian consumers. At the very least, the price maintenance standard better protects consum-

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128 This will be examined in detail at a later point.

129 "Trade Winds", *The Economist*, 6 November 1997, online: [http://www.economist.com/displayStory.cfm?Story_ID=105723] (date accessed: 3 November 2004).

130 S.F. ROSS, *loc. cit.*, note 8, 95.

131 See: Exhibit 4.

132 See: Exhibit 5.

133 See: Exhibit 6.

ers against this – merger review would *ex ante* aim for constant post-merger prices which means efficiencies could still be exported abroad, but additional revenues from price increases would not.

Cross-border M&A have steadily increased in OECD countries and globalization is obviously a major factor for this trend[134]. The inflows and outflows into Canada regarding cross-border M&A transactions again indicate that money flowing into the country was rising from 1998 to 2001[135]. As was the case with FDI, foreign corporations earn revenues in Canada and export a large portion of this wealth to foreign shareholders. Approved cross-border mergers that are permitted to proceed due to projected cost savings and likely price increases may be misplaced because foreign shareholders will benefit from the merger and will prejudice Canadian consumers in so doing. Wealth is not only transferred to foreign shareholders, but foreign consumers benefit from price increases on Canadian soil as well. *Superior Propane* is a salient example of this phenomenon. 63% of the propane produced in Canada was exported to the US[136]. The Canadian propane market may no longer be competitive because one company now serves over 70% of the aggregate market, but the US market remains competitive. The price increase for propane can therefore only take effect in Canada, which is now essentially a monopoly, whereas competitive prices will still be in effect in the US. Canadian propane consumers are thus subsidizing foreign consumers which is counter-intuitive and unsatisfactory from a policy perspective[137].

Much of the analysis in the competition law literature has been on the effect of a price increase on individuals and not on corporate consumers. The Competition Tribunal, oddly enough, ignored the impact of higher propane prices on corporate consumers, despite the fact that 90% of propane in Canada is for non-residential use. The Tribunal believed that the effect or likely effect of the price increase would be inconclusive on corporate consumers[138]. In fact,

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134 See: Exhibit 7.

135 See: Exhibits 8 and 9. There was a drop in M&A activity in 2001 because of general macroeconomic conditions. However, M&A activity has since resumed.

136 D. TADMOR, *loc. cit.*, note 32, 82.

137 Id.

138 *Tribunal 2002 Decision*, *supra* note 3 at para. 254.

"[c]heap Canadian propane will … fuel U.S. industries; these industries, in turn, will have an edge when competing with Canadian firms for which the merger has raised production costs"[139]! Canadian firms will thus be able to compete less effectively against U.S. firms and effectively helps price discriminate against themselves[140]. This self-price-discrimination, so to speak, is exacerbated by the fact that the demand of Canadian firms is more elastic than that of American firms. Ms. Lloyd's dissenting judgment therefore seems correct in that propane is an important input for business production processes. It is impossible to quantify the cost increase of propane because of the innumerable business impact, but she is justified in stating that its impact must nonetheless be accounted for[141].

The purpose clause of the *Competition Act* clearly states that the efficiency of the Canadian economy is important, as is its participation in world markets. The efficiency defence, as applied in *Superior Propane*, directly contravenes this fundamental purpose because Canadian firms using propane have higher resulting cost structures from the merger which leads to their inability to compete internationally. The price maintenance test would have avoided these complex issues because it would not have approved the Superior Propane/ICG transaction due to the forecasted 8% price increase of propane.

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* *

Merger law in Canada took a distinctive turn when the FCA rendered its final judgment in *Superior Propane*. Rather than adopting a standard that promotes efficiency and consumer interests at the same time, Canada now has an efficiency defence pursuant to the balancing weights approach that is: difficult to understand, laden with value judgments, complex to implement, and is inequitable to consumers. The business community and its legal counsel consequently experience difficulty in determining the application of the efficiency defence to M&A transactions. This paper has explained why *Superior Propane* is flawed. The efficiency defence is meant to

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139 *Id.*

140 See: Michael TREBILCOCK, R.A. WINTER, P. COLLINS and E.M. IACOBUCCI, *The Law and Economics of Canadian Competition Policy*, Toronto, University of Toronto Press, 2002, at 339 and following for the law on price discrimination.

141 R.W. LUSK, *loc. cit.*, note 83, 40; *Tribunal 2002 Decision*, *supra* note 3 at paras. 410-414.

increase efficiency in the Canadian economy, protect consumers, and help firms become or stay internationally competitive. The decision achieved the contrary.

A consequence of the merger of Superior Propane and ICG is the forecasted price increase of propane by at least 8% across Canada – the salutary effects of the merger were nonetheless quantified to significantly exceed its anti-competitive effects under the total surplus and balancing weights approaches. In the year 2000, 18.9% of Canadian wealth was invested in stock[142] and this wealth was concentrated in far fewer hands. The majority of Canadians thus operate in society not as shareholders but as consumers. The efficiency defence in *Superior Propane* misappropriated wealth from consumers to producers. It is unfortunate that the Competition Tribunal and FCA have encouraged this form of "reversed robinhoodism." But another consequence of the defence has been to subsidize American firms, since 63% of propane produced in Canada is exported to the US where propane is sold at competitive prices[143]. Canadian firms are consequently less competitive internationally and are now forced to pay higher prices for the same input. The Competition Tribunal refused to recognize these effects because of their "inconclusive" impact on corporate consumers. Canadian law unfortunately now allows mergers-to-monopoly, "… even if cross elasticity of demand is very low, cross elasticity of supply is very low and the resulting monopoly will possess very strong market power – provided cost savings to the merging parties are expected to exceed all deadweight loss arising from the probable increase in price to the public"[144].

It is perhaps not surprising, as notes Sheridan Scott, that Canada is the only country within the OECD having an efficiency defence[145]. The existence of the defence can mean one of two things. First, Canada may have the most economically advanced competition merger law in the world[146]. Second, Canadian competition merger law requires strengthening. The latter interpretation appears more reasonable. The Competition Tribunal correctly noted in *Superior Propane* that

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142 See: Exhibit 5.

143 D. TADMOR, *loc. cit.*, note 32, 82.

144 *Id.*, 79.

145 *Speaking Notes for Sheridan Scott 1*, *op. cit.*, note 5 at 12.

146 M. BARUTCISKI & B.A. FACEY, *loc. cit.*, note 37, 36.

its role is to apply the *Competition Act* and in so doing, promote competition to ultimately enhance efficiency in the Canadian economy[147]. The role of Parliament is different. The policy-making process must devise a set of rules that can differentiate between welfare enhancing and welfare reducing mergers. The current efficiency defence is *sine qua non* of consumer unfriendliness.

This paper has proposed the amendment of the efficiency defence through the "price maintenance standard." This standard allows the merging of firms for cost saving purposes, but does not allow a merger to proceed where a post-merger price increase is forecasted. The price maintenance standard thus advocates price stability *ex ante*, and transactions where evidence indicates product prices will increase would not be allowed. Aggrieved parties must, however, be able to redress egregious post-merger price increases. Highly circumscribed *ex post* regulation should therefore be possible, but only in the most exceptional circumstances. For example, a 50% price increase would clearly be egregious. A standard calling for *ex ante* price stability recognizes that the majority of Canadians operate as consumers in society, in addition to being far easier to implement that the value-based balancing weights approach. Strong merger laws must be predictable such that legal counsel can advise their clients with full certainty regarding the state of law in Canada for M&A transactions. Predictability regarding mergers in the Canadian economy will reduce transaction costs and allows potential litigants to deal with the Competition Bureau defensively as opposed to offensively. The price maintenance standard, in its aggregate, promotes efficiency in the Canadian economy while satisfying a number of competing objectives in the purpose clause of the *Competition Act*, not least of which is the provision of competitive prices and product choices to consumers. The standard is not economically perfect, but neither are other competing economic tests. Effective policy-making goes beyond an unadulterated economic analysis and is fundamentally interdisciplinary in nature. This paper can only hope that Parliament will retain its proposed consumer-friendly proposal to the efficiency defence in the near future and end the current dark period of "reversed robinhoodism" in Canadian competition policy.

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147 *Tribunal 2002 Decision*, *supra* note 3 at para. 208.

Appendix

Exhibit 1: Geographical Markets with Mergers-to-Monopoly

	Pre-Merger		Post-Merger
Market	SPI %	ICG %	SPI %
Val d'Or	74	23	97
Sept Iles/Baie Comeau	55	45	100
Bancroft/Pembroke/Eganville	92	5	97
Dryden/Fort France/Kenora/Ignace	47	52	99
Echo Bay/Sault Ste Marie	55	44	99
Hearst/Wawa/Manitouwadge/Marathon	43	53	96
Little Current/Sudbury	51	48	99
North Bay	81	16	97
Thunder Bay	46	54	100
Fort McMurray	32	67	99
Whitecourt	55	45	100
Burns Lake/Terrace/Smithers/ Prince Rupert	62	37	99
Fort Nelson	44	56	100
Valemont	43	57	100
Watson Lake	25	75	100
Whitehorse	33	67	100

Source: FCA 2003 at para. 70.

Exhibit 2: Proportion of Household Wealth in Shares

% of Total Wealth

	1980	1995	2000
Canada	13.3	14.1	18.9
France[1]	5.7	17.5	26.8
Germany	2.2[2]	7.5	12.9
Italy[1]	2.5	9.6	26.5
Japan	4.7	5.8	5.3
United Kingdom	5.5	13.6	14.6
United States	9.6	19.6	25.3

1. France and Italy's estimates for household equity holding unquoted shared.
2. 1990.

Source: OECD

Exhibit 3: Pattern of Share Holdings Across Selected G7 Countries

Income group (€)[1,2]	Percentage of population	Years	
Germany[3]		**1997**	**2000**
< 1 300	21.1	1.7	3.0
1 300-2 050	29.4	3.9	5.8
2 050-3 050	33.1	8.3	11.4
3 050-4 100	9.8	14.6	20.4
> 4 100	6.6	18.7	25.9
Total	**100.0**	**6.2**	**9.8**
France		**1997**	**2000**
< 1 500	32.3	6.1	7.4
1 500-2 300	32.2	10.1	11.2
2 300-3 050	18.3	15.5	14.3
3 050-3 800	8.4	19.1	21.1
> 3 800	8.5	32.6	31.4
Total[4]	**100.0**	**12.0**	**12.7**
Italy		**1995**	**1998**
< 850	17.6	0.2	0.6
850-1 700	33.4	2.0	2.4
1 700-2 600	22.9	5.0	5.7
2 600-3 450	13.5	10.3	11.9
> 3 450	12.6	21.7	31.7
Total	**100.0**	**5.0**	**7.8**
United Kingdom[5]		**1993**	**1996**
Lower quartile	25.0	8.2	13.4
Middle-lower quartile	25.0	14.8	15.6
Middle-upper quartile	25.0	27.0	26.5
Highest quartile	25.0	41.3	37.9
Total	**100.0**	**22.8**	**23.3**
United States		**1995**	**1998**
< 850	12.6	2.3	3.8
850-2 100	24.8	8.4	7.2
2 100-4 150	28.8	13.9	17.7
4 150-8 350	25.2	24.7	27.7
> 8 350	8.6	43.6	56.6
Total	**100.0**	**15.2**	**19.2**

Note: The table shows the proportion of each income group holding direct equities excluding mutual funds – for example, in 1997, 1.7 per cent of all German income earners earning less than EUR 1 300 per month owned direct equities excluding mutual funds. Percentage of population in each respective income group for latest available year.

1. Income groups by monthly net income, rounded to nearest unit of 50 (€, £, $).
2. UK data by income quartiles, based on net household income.
3. German data include employee share ownership schemes.
4. Total does not sum exactly due to rounding.
5. Includes unit trusts, PEPs and government gilts.

Source: Bank of England, Deutsches Aktieninstitut, Deutsche Bundesbank, Banque de France/Paris Bourse, Banca d'Italia, Institute for Fiscal Studies and Federal Reserve Board.

Exhibit 4: Direct Investment Flows, OECD Countries, 1998-2001 (US billions)

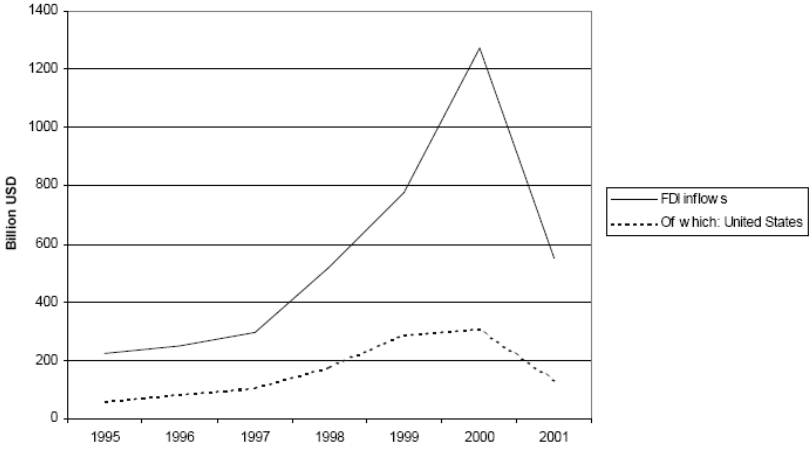
	Inflows				Outflows			
	1998	**1999**	**2000 p**	**2001 e**	**1998**	**1999**	**2000 p**	**2001 e**
Australia	6.1	5.7	11.9	5.1	3.4	3.0	5.1	11.4
Austria	4.5	3.0	8.8	5.9	2.7	3.3	5.7	3.0
Belgium-Luxembourg	22.7	38.7	243.3	51.0	28.5	34.0	241.2	67.3
Canada	22.6	25.2	63.3	27.6	34.6	18.4	44.0	37.0
Czech Republic	3.7	6.3	5.0	4.9	0.1	0.1	0.0	0.1
Denmark	7.7	6.8	14.5	4.1	4.5	7.0	6.6	6.1
Finland	12.1	4.6	8.8	3.6	18.6	6.6	24.0	7.3
France	31.0	47.1	42.9	52.6	48.6	120.6	175.5	82.8
Germany	24.6	54.8	195.2	31.8	88.8	109.4	49.8	43.3
Greece	..	0.6	1.1	1.6	n.a.	0.5	2.1	0.6
Hungary	2.0	2.0	1.6	2.4	0.5	0.3	0.6	0.3
Iceland	0.1	0.1	0.2	0.2	0.1	0.1	0.4	0.3
Ireland	8.9	19.0	24.1	9.8	3.9	5.4	4.0	5.4
Italy	4.3	6.9	13.4	14.9	16.1	6.7	12.3	21.5
Japan	10.2	21.1	29.0	17.9	39.9	65.3	49.8	32.5
Korea	5.2	10.7	10.1	3.2	3.4	2.1	3.5	2.6
Mexico	11.9	12.5	14.7	24.7	..	..	..	3.7
Netherlands	37.9	31.9	54.3	55.6	38.8	41.5	72.0	44.4
New-Zealand	1.8	0.9	1.3	3.2	0.4	1.1	0.6	0.7
Norway	4.0	7.5	6.0	2.2	2.5	5.5	8.3	-1.0
Poland	6.4	7.3	9.3	6.8	0.3	0.0	0.0	0.1
Portugal	3.1	1.2	6.4	3.3	3.8	3.2	7.7	5.1
Slovak Republic	0.5	0.4	2.1	0.6	0.1	-0.4	0.0	0.1
Spain	11.8	15.8	37.5	21.8	18.9	42.1	54.7	27.8
Sweden	19.6	60.9	23.4	12.9	24.4	21.9	40.6	6.4
Switzerland	8.9	11.7	16.3	10.0	18.8	33.3	42.7	16.3
Turkey	1.0	0.8	1.7	3.3	0.4	0.7	1.0	0.6
United Kingdom	70.6	82.9	119.7	53.8	121.8	205.8	255.1	39.5
United States	179.0	289.5	307.7	130.8	142.6	188.9	178.3	127.8
TOTAL OECD	**522.6**	**775.6**	**1274.0**	**565.8**	**666.7**	**926.6**	**1285.6**	**593.1**

Note: Data are *converted* using the yearly average exchange rates.

Greece: *1999*-2001, source is IMF.
Korea and Netherlands: 2001, source is IMF.
Hungary: 1998, source is IMF.
Slovak Republic: Data include only equity capital. 2001 data cover Jan-Sep 2001.

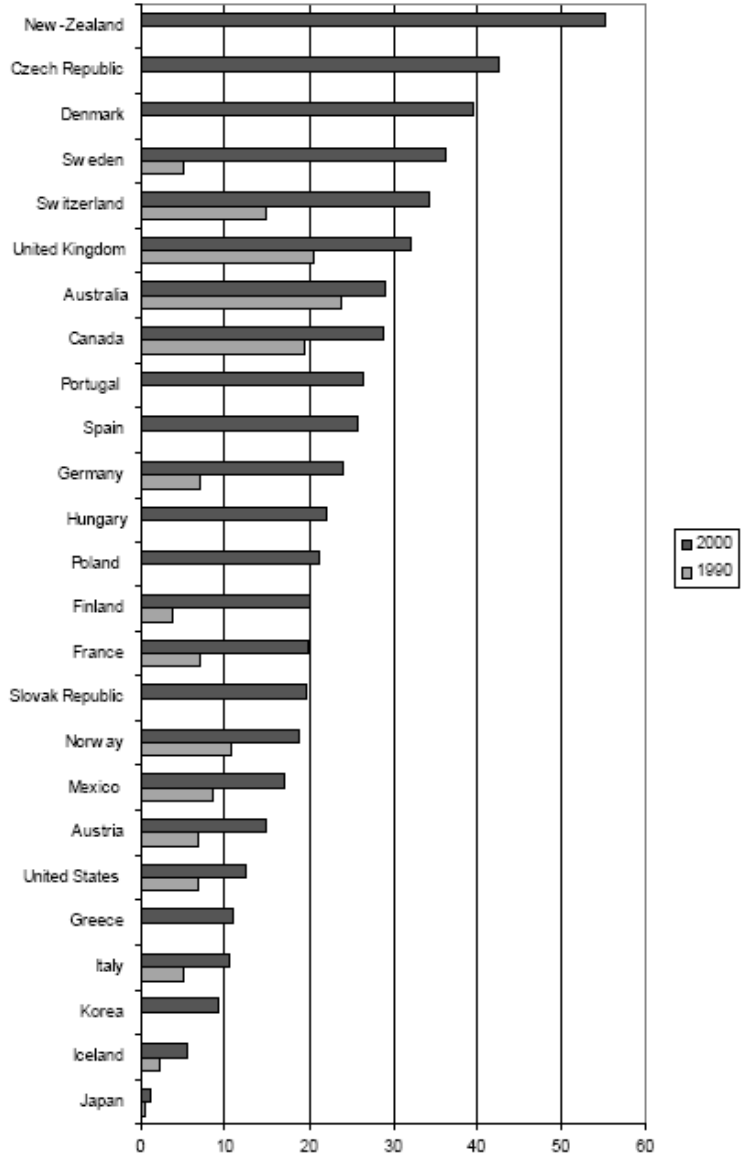
Source: OECD International Direct Investment Database.

Exhibit 5: FDI Inflows into OECD Countries



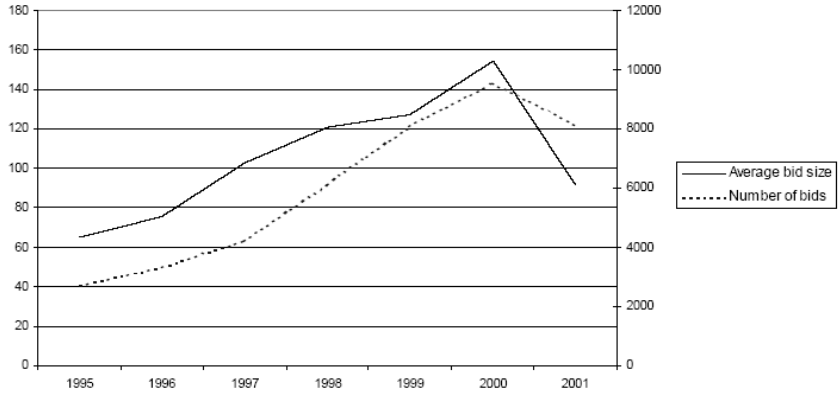
Source: OECD International Investment Statistics

Exhibit 6: Inward FDI Position
(as Share of Domestic GDP)



Source. OECD International Direct Investment Database.

Exhibit 7: Global Cross-Border Mergers and Acquisitions: Bids and Bid Sizes



Source: OECD International Investment Statistics

Exhibit 8: Cross-Border Mergers and Acquisitions: Inflows by Country (US billions)

	1998	1999	2000	2001	Jan-12 Jun 2002
OECD	**617.4**	**879.6**	**1272.4**	**636.3**	**199.4**
Australia	12.8	29.2	19.2	17.6	5.6
Austria	4.4	0.2	2.7	10.3	0.1
Belgium-Luxembourg	65.4	37.9	12.5	18.9	16.0
Canada	18.3	31.2	139.3	50.9	14.4
Czech Republic	2.9	3.4	2.9	2.0	4.4
Denmark	9.6	6.5	14.1	1.5	1.3
Finland	22.7	4.9	5.0	4.3	2.7
France	38.5	29.3	50.8	27.5	14.8
Germany	20.1	63.8	293.2	60.8	25.4
Greece	3.8	7.1	1.4	1.3	0.0
Hungary	1.2	1.1	3.9	0.6	1.0
Iceland	0.0	0.1	0.0	0.0	0.0
Ireland	0.7	6.9	5.5	6.5	0.5
Italy	27.9	42.7	20.1	17.0	4.1
Japan	19.3	22.9	19.9	17.8	3.3
Korea	7.3	19.6	9.7	11.4	0.6
Mexico	3.5	1.2	25.4	16.3	3.9
Netherlands	28.4	45.8	40.0	16.1	11.0
New Zealand	2.6	4.8	4.4	3.3	0.3
Norway	1.5	6.2	10.2	5.3	0.4
Poland	2.8	7.3	10.4	3.5	0.5
Portugal	5.4	2.9	9.8	0.8	0.7
Slovakia	0.0	0.1	1.8	1.3	3.4
Spain	17.0	13.0	24.9	9.7	9.6
Sweden	14.0	58.7	29.0	12.8	3.9
Switzerland	16.4	19.0	28.4	17.4	5.9
Turkey	0.3	0.1	3.6	0.7	0.1
United Kingdom	80.5	147.6	214.8	112.7	30.9
United States	189.8	265.9	269.5	188.0	34.3
Selected other countries					
Israel	3.6	4.8	3.5	4.6	0.4
Hong Kong, China	3.7	9.5	15.1	13.8	0.4
China	4.5	10.2	45.2	5.4	1.5
Singapore	0.8	5.9	2.2	6.3	0.4
Brazil	31.1	11.1	34.4	9.6	2.9
Argentina	12.7	25.1	11.5	5.5	0.1
Chile	2.7	8.3	4.6	5.1	1.6

Source: Dealogic

Exhibit 9: Cross-Border Mergers and Acquisitions: Outflows by Country (US billions)

	1998	1999	2000	2001	Jan-12 Jun 2002
OECD	**545.9**	**803.2**	**1115.8**	**573.3**	**185.2**
Australia	6.8	10.8	7.0	37.0	5.5
Austria	1.4	2.2	3.6	1.3	0.9
Belgium-Luxembourg	6.1	11.7	19.1	21.7	4.1
Canada	40.2	16.4	42.0	30.0	4.9
Czech Republic	0.0	0.0	0.0	0.0	0.1
Denmark	2.5	5.8	6.6	4.3	0.9
Finland	10.4	4.0	13.0	9.1	3.8
France	39.8	124.6	151.6	66.9	24.4
Germany	77.2	112.8	80.6	70.5	26.6
Greece	1.3	0.6	4.0	0.2	0.3
Hungary	0.1	0.0	0.4	0.0	0.0
Iceland	0.0	0.0	0.1	0.0	0.1
Ireland	3.6	3.6	4.8	1.8	0.4
Italy	13.1	14.7	19.7	21.8	3.1
Japan	8.1	21.6	22.7	21.8	1.9
Korea	0.1	0.1	1.6	0.1	0.0
Mexico	0.4	4.1	4.6	0.7	0.8
Netherlands	38.6	48.5	71.1	31.9	13.2
New Zealand	0.1	1.0	1.2	0.6	0.0
Norway	1.2	1.5	7.9	2.5	4.4
Poland	0.0	0.0	0.0	0.0	0.0
Portugal	4.7	2.4	5.4	1.7	0.9
Slovakia	0.0	0.0	0.0	0.0	0.0
Spain	17.0	34.7	60.3	8.5	5.2
Sweden	30.4	12.4	22.9	11.5	3.2
Switzerland	27.7	15.1	41.7	21.2	0.9
Turkey	0.1	0.6	0.0	0.0	0.0
United Kingdom	106.3	196.7	372.6	84.6	32.5
United States	108.8	157.2	151.2	123.4	47.1
Selected other countries:					
South Africa	3.4	6.5	4.3	2.1	0.85
Bermuda	11.8	38.0	10.4	16.4	1.3
China	2.0	0.7	1.4	1.4	0.5
Hong Kong, China	7.0	13.6	48.9	4.9	1.9
Singapore	0.6	5.0	14.5	16.2	0.9

Source: Dealogic