

## CANADIAN COMPETITION RECORD

### ACQUISITION OF CANADA TRUST BY TD BANK - A COMMENTARY ON THE COMPETITION BUREAU'S CONCLUSIONS REGARDING COMPETITIVE IMPACT IN THE MARKETS FOR BRANCH BANKING SERVICES

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#### Introduction

The conclusions reached by the Competition Bureau in assessing the competitive impact of the Canada Trust acquisition on branch banking raise a number of competition policy issues. These include the Bureau's articulation of its conclusions regarding competitive impact in quantitative, rather than qualitative, terms. While there may be circumstances in which market share levels are sufficiently high to establish a *prima facie* substantial lessening of competition, the Canada Trust acquisition was clearly not such a case. As a result, the Bureau's analysis departs from its articulated framework for merger review and, thereby, adds uncertainty to the merger review process in Canada.

#### Background

On January 28, the Bureau completed its review of the acquisition of Canada Trust by TD Bank. In its letter (the "Reporting Letter") to Charles Baillie, the Chairman and CEO of TD Bank, and Edmund Clark, the President and CEO of Canada Trust, the Bureau stated:

After a comprehensive review, the Bureau has concluded that, as proposed, the merger is likely to substantially lessen or prevent competition, and that this would lead to higher prices and lower levels of service and choice for branch banking consumers in three local markets: Kitchener-Waterloo-Cambridge-Elmira; Port Hope; and Brantford-Paris. The Bureau has also concluded that the merger will substantially lessen or prevent competition in the general-purpose credit card networks market in Canada.

The Bureau noted that, in response to its concerns, TD Bank proposed to sell branches in the three identified (*i.e.*, problematic) markets. The bank also proposed to either sell the Canada Trust MasterCard credit portfolio or convert its VISA credit card portfolio to MasterCard. The Bureau stated that, in its view:

[t]hese proposed remedies, once fully implemented, will address the anti-competitive impact of the proposed merger.

Based on the recommendations of the Bureau and OSFI, the Minister of Finance announced on January 31 that the Government had approved the Canada Trust acquisition.

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**Commentary**

Like its assessment of the proposed 1998 bank mergers (the "Bank Mergers"), the Bureau expressed its conclusions regarding the competitive impact of the Canada Trust acquisition on branch banking with reference to the parties' post-merger combined share of certain business lines in the geographic markets affected by the transaction. After a fairly high-level discussion of the evaluative criteria in Section 93 of the *Competition Act*, the Bureau stated that the acquisition:

will result in a substantial lessening of competition in the markets for either personal or business transaction accounts where the parties' combined market share would be 45% or more in the local geographic market.

The Bureau also stated more generally that a merger will be likely to prevent or lessen competition substantially where it "is likely to result in higher prices, less choice or reduced service" - in other words, where the merging parties will be in a position to exercise market power.

However, the Bureau's analysis of the Canada Trust acquisition (as set out in the Reporting Letter) does not establish the link between market share and market power that must necessarily underlie the Bureau's conclusions.<sup>2</sup> This is problematic for three reasons. First, there would appear to be little economic support for the view that market share alone is necessarily indicative of market power, and there is no reference to any such presumption in the *Merger Enforcement Guidelines as Applied to a Bank Merger* (the "BMEGs"). Second, the Act makes it clear that conclusions regarding the competitive impact of a merger cannot be based solely on evidence of concentration or market share. Third, to the extent that the Bureau's published analysis in a high profile merger transaction departs from the review framework articulated in its own enforcement guidelines, the Bureau undermines its stated objective of providing a "clearer view of how the merger review process will be applied...in keeping with the Bureau's open, transparent, and predictable approach to enforcing the Act".

The BMEGs describe the framework which the Bureau uses to assess the competitive effects of a bank merger. In general, this framework involves defining the relevant markets, conducting an initial screening test to identify markets affected by the merger which do not require further analysis and, where a market fails to pass the initial screening test, conducting a more thorough review of the merger on a market-by-market basis. With respect to the second and third stages of the analysis, the BMEGs provide as follows:

The [second] stage in the analysis is the application of market share and concentration thresholds, which distinguish mergers that are unlikely to have anti-competitive consequences from mergers that require further analysis...The purpose of such a screen is to quickly eliminate from further review the products and geographic areas which are not likely to give rise to competition concerns in order to focus the Bureau's review....The products and geographic areas which "fail" the initial screen are then subject to a complete competitive effects analysis.

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The BMEGs are clear both in their words and intent that, once the initial screening test has been completed, it is the evaluative criteria that are to be used to assess the likelihood that a bank merger will prevent or lessen competition substantially. While evidence of concentration or market share may be an important preliminary evaluation tool (*i.e.*, at the initial screening stage), and while market share information may be a relevant starting point for a more thorough competitive effects analysis, the focus of merger assessment, both as set out in the Act and as described in the BMEGs, is and should be on the likely post-merger competitive environment and the likelihood that the merging parties will be in a position to exercise market power. This requires the Bureau to consider other competitive factors, such as the excess capacity of other firms in the market, barriers to entry and the effectiveness of remaining competitors, that are likely to either off-set or reinforce any preliminary conclusions regarding competitive impact which the Bureau may reach based on its market share observations alone.<sup>3</sup>

With respect to the Canada Trust acquisition, the Bureau stated in the Reporting Letter that its analytical approach presumes a merger will not harm competition when markets are unconcentrated, entry is easy and effective competition remains. While the Bureau concluded (as it did during its review of the Bank Mergers) that, in general, barriers to entry into retail banking on a “bricks and mortar” basis are high, nowhere in its analysis of the Canada Trust acquisition does the Bureau state its conclusions with respect to the issue of effective remaining competition in specific geographic markets. As a result, we are left to conclude by implication that, following the transaction (and absent a divestiture remedy), concentration in the problematic markets would be high, effective competition would not remain, and an unacceptable degree of market power would exist. However, this conclusion is not at all apparent on the facts.

Consider, for example, Port Hope, Ontario. In this market, each of Royal Bank, Bank of Montreal, CIBC and Bank of Nova Scotia operates one branch, as does each of TD Bank and Canada Trust. There is also one credit union branch. In these circumstances, absent the one branch divestiture required by the Bureau in Port Hope, the Canada Trust acquisition would have increased TD’s market presence from one to two branches, which would have faced competition post-merger from one branch of each of the other major Schedule I banks (“Major Banks”) and a credit union. While, based on the Bureau’s market share information, the transaction would have resulted in an increase in TD Bank’s post-merger market share in Port Hope to something in excess of 45% (precise information was not provided to the parties nor is it set out in the Reporting Letter), the Bureau makes no attempt in the Reporting Letter to explain how, given the number of effective competitors<sup>4</sup> that would remain in the market, this level of market share would or might translate into an ability to exercise market power.

One might have argued that, absent the required divestiture, TD Bank’s market share in Port Hope likely would have been eroded by competition from the other Major Banks if, post-merger, TD Bank attempted to increase the prices of its retail banking products or reduce service levels. However, the Bureau’s analysis does not address the likely post-merger competitive dynamics in the Port Hope market. Rather, the Bureau appears to conclude that, since TD Bank would have a post-merger

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market share in excess of 45% (based on pre-merger market share information), market power should be presumed and a divestiture must be required.

It is also worth mentioning that the Bureau's conclusions regarding the competitive impact of this transaction (expressed, as they were, as conclusions relating to market share) appear somewhat difficult to reconcile with its conclusions regarding the competitive impact of the Bank Mergers. Specifically, the Bureau's conclusions regarding the competitive impact of the Bank Mergers (also expressed as conclusions relating to the merging parties' combined post-merger market shares) were made in the context of a proposed consolidation in the number of Major Banks from five to three. The Canada Trust acquisition, on the other hand, combined Canada's fifth largest bank with a trust company one quarter its size. As such, the Canada Trust acquisition had a limited impact on the number of effective competitors in most geographic markets affected by the transaction (in Port Hope, for example, the number of clearly effective competitors declined from six to five). Nevertheless, the Bureau appears to have applied to its analysis of the Canada Trust acquisition the "guidelines" which it developed during the Bank Merger review (*i.e.*, market share guidelines, which reflected the Bureau's general assessment of the section 93 evaluative criteria). The Bureau stated in the Reporting Letter:

In assessing competitive criteria, the Bureau relied on the conclusions it reached during its reviews of the proposed bank mergers in 1998. There have been no significant developments since then and no evidence presented that suggests those conclusions would not be applicable to this transaction.

This is a somewhat curious statement, at least insofar as it relates to the issue of effective remaining competition, given that the Bank Mergers did not proceed.

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By expressing its conclusions regarding the competitive impact of the Canada Trust acquisition on branch banking as conclusions relating to market share, rather than market power, the Competition Bureau's analysis departs from its articulated framework for merger review. Unless the Bureau wishes to be seen to have based its decisions either primarily or solely on evidence of market share - which is inconsistent with both the Act and the BMEGs and, as a result, with the Bureau's stated policy objectives of transparency and predictability in the enforcement of the Act - the Bureau's future merger decisions should more clearly relate its conclusions regarding competitive impact to the Section 93 evaluative criteria.

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## Notes

<sup>1</sup> Jay Holsten is Chair of the Antitrust and Competition Law Group at Torys. He advised TD Bank on the competition law aspects of its proposed 1998 merger with CIBC and the acquisition of Canada Trust.

<sup>2</sup> The BMEGs provide that a prevention or lessening of competition can only result from a merger where the parties to the merger are, or would likely be, able to exercise a greater degree of market power, unilaterally or interdependently with others, than if the merger did not proceed.

<sup>3</sup> In *Hillsdown*, the Competition Tribunal noted that the various market share calculations relied upon by the Bureau in that case indicated that the merger “[increased] market share considerably in an already highly concentrated market and [gave] rise to at least an initial concern that the merger [would] likely substantially lessen competition in that market”. However, the Tribunal went on to state that “[a]s has already been noted, market share is not necessarily a reliable determinant of market power. As an indicia of such it may either overstate or understate a firm’s market power”.

<sup>4</sup> The Bureau concluded during its review of the Bank Mergers that, as the first and third-largest banks in Canada, Royal Bank and Bank of Montreal are “obviously effective competitors” (Royal Bank/Bank of Montreal letter, page 11). The Bureau also concluded that, as the second-largest bank in Canada, CIBC is an “obviously effective competitor” (TD Bank/CIBC letter, page 15). Given that the Bank Mergers did not proceed, Bank of Nova Scotia would also presumably be regarded as an effective competitor today in the various markets in which it competes.

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