

CANADIAN COMPETITION RECORD

SPECIAL SECTION ON SUPERIOR PROPANE

THE COMMISSIONER OF COMPETITION v. SUPERIOR PROPANE - THE TRIBUNAL STRIKES BACK

By: R. Jay Holsten¹
Torys

The *Superior Propane* redetermination decision² issued by the Competition Tribunal on April 4, 2002 raises one of the most interesting competition policy debates in Canada in recent years. While the central issue and focus of the Decision is the appropriate standard for the efficiencies/effects trade-off under section 96 of the *Competition Act*, the Decision raises a far more fundamental question: namely, the purpose of Canadian competition law.

According to the Competition Bureau, its role in administering and enforcing the Act - including its role in merger review - is to promote and maintain competition so that Canadians can benefit from lower prices, better product choices and improved services.³ According to the Tribunal, consumer protection is not the main goal of the Act or of the merger provisions in particular - the focus of the merger provisions is the efficient allocation of economic resources and, in balancing efficiencies against anticompetitive effects in merger review, there is no policy choice in favour of consumers.⁴

How this policy debate plays out will be of significance beyond the interpretation of section 96. It is not surprising then that, on April 17, the Bureau announced that it had filed a notice of appeal in the matter citing this "fundamental disagreement" as one of the key reasons for its decision.

Background

In December 1998, the Commissioner applied to the Tribunal for an order dissolving the merger of Superior and ICG. In its initial decision in August 2000⁵, a majority of the Tribunal held that, while the merger of Superior and ICG would substantially prevent and lessen competition, the merger would bring about gains in efficiency that would be greater than and would offset its anticompetitive effects. As a result, the order sought by the Commissioner was denied.

In its analysis and interpretation of the section 96 efficiencies/effects trade-off, the Tribunal initially adopted the total surplus standard, which compares the efficiency gains brought about by a merger with the efficiency costs of the merger (as represented by the expected loss of resources to the economy as a whole - i.e., the deadweight loss). Under this approach, the income/wealth loss to consumers (as a result of the price increase expected to result from the merger) and the corresponding income/wealth gain (in the form of excess profits) to producers (i.e., the shareholders of the merged firm) are regarded as offsetting, and were not considered by the Tribunal to be anticompetitive effects of the merger for section 96 purposes.

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On appeal, the Federal Court of Appeal held that the Tribunal erred in law by limiting the effects to be considered under section 96 to resource allocation effects and thereby “failed to ensure that all of the objectives of the [Act], and the particular circumstances of each merger, could be considered...”⁶ While the Court did not attempt to prescribe the correct methodology for determining the extent of the anti-competitive effects of a merger,⁷ it did state that “whatever standard is selected must be more reflective than the total surplus standard of the different objectives of the” Act, and should be “sufficiently flexible in its application to enable the Tribunal fully to assess the particular fact situation before it”. The Court then remitted the matter to the Tribunal for redetermination “in a manner consistent with the Court’s reasons”.

The Redetermination Decision

While it was clear as a result of the Appeal Judgment that the Court did not agree with the Tribunal’s interpretation of section 96, it is clear from the Decision that the Tribunal disagrees with much of the reasoning that underlies the Court’s rejection of the total surplus standard.⁸ The Decision reflects particular concern on the part of the Tribunal with the Court’s discussion of and views regarding the legislative history of section 96 and the statutory purpose and objectives of the Act.⁹ As a result, while the Decision ostensibly reflects the Court’s redetermination instructions, a significant portion of the Decision is devoted to “expanding upon” the Court’s remarks in the Appeal Judgment “in order to provide for a better understanding of these issues”. Or, in other words, setting the record straight. Based on its review, the Tribunal concludes that:

- Parliament clearly understood that consumer protection was not the main goal of the Act or of the merger provisions in particular.¹⁰ Rather, “the primary reason for amending the [Act] in 1986 was the need to strengthen Canadian business and provide an incentive for productivity in the face of aggressive international competition to which the government was committed and which would ultimately benefit consumers”.¹¹
- While it was a clear concern of Bill C-256 (1970-71) that the redistributive effects of anticompetitive mergers saved by efficiency gains not harm consumers beyond a reasonable period of time, this concern “was successively de-emphasized in subsequent bills”.¹²
- Efficiency (and not consumer protection) is the paramount objective of the merger provisions of the Act.¹³

As a result, the Tribunal concludes that, having been instructed by the Court to reconsider the anticompetitive effects of the merger in circumstances in which the Court did not prescribe the method by which the Tribunal should perform its task, it “must follow [its] instruction in light of [a] clear legislative history that indicates that the merger provisions were not driven by consumer interest”. In the Tribunal’s view, to do otherwise would be to adopt an approach to section 96 that prevents efficiency-enhancing mergers in all but the rarest circumstances, which the Tribunal concludes “must be wrong in law”.¹⁴

In its redetermination of the appropriate standard for the section 96 efficiencies/effects trade-off, the Tribunal discusses and rejects the consumer surplus approach, under which a merger will be approved only if the efficiencies brought about by the merger exceed the sum of the deadweight loss and the income/wealth redistributed from

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consumers to producers.¹⁵ The Tribunal ultimately adopts what might be described as a balancing weights (plus) approach, using a balancing weights approach¹⁶ to quantify the adverse redistributive effects of the merger and assessing the other anticompetitive effects of the merger on a qualitative basis.¹⁷

Significantly, with respect to all anticompetitive effects of the merger other than adverse redistributive effects, the Tribunal concludes that there is not sufficient evidence before it to make any effects determination, on either a quantitative or qualitative basis.

With respect to the redistributive effects of the merger, the Tribunal rejects the Commissioner's position that the entire amount of the income/wealth transfer is an adverse effect that should be included in its balancing weights assessment.¹⁸ The Tribunal states:

There is some confusion over terminology. The Tribunal does not consider the redistribution of income that results from an anti-competitive merger to be an "anti-competitive effect". Rather...the redistributive impacts are among the [anticompetitive] effects...that the merger...is likely to bring about. Redistribution of income and/or wealth occurs in many different ways in society, and often has nothing to do with competition policy. For example, government may redistribute income through the tax system or through public expenditures without transferring income anti-competitively.

The Tribunal notes the distinction for greater certainty because it is a distinction that is not made by the Court... At places in its Appeal Judgment the Court appears to refer to the redistributive effect as an anti-competitive effect, but such reference may reflect a convenient vocabulary rather than a statement of judicial understanding. In line with conventional economic analysis, the Tribunal does not regard the wealth transfer as anti-competitive or as a misallocation of resources. An anti-competitive effect is a misallocation of resources that reduces society's aggregate real income and wealth. A transfer redistributes income and wealth within society but does not reduce it.¹⁹

Based on its review of the evidence, the Tribunal also rejects Superior's position that the redistributive effects of the merger are completely neutral. In the Tribunal's view,

the evidence tends to support the socially adverse redistributive effects regarding low income households that use propane for essential purposes and have no good alternatives, but the number of such households appears to be small.²⁰

As a result, the Tribunal concludes that the interests of these low income households should be weighted more heavily than the interests of shareholders of the merged firm (i.e., producers)²¹. The Tribunal concludes that the interests of other households and business owners should be weighted equally with those of the shareholders of the merged firm.

Applying this balancing weights analysis, the Tribunal concludes that the measured adverse redistributive effect of the merger (as distinct from the amount of the redistribution itself) is approximately \$2.6 million. Combined with a measured deadweight loss of \$3 million and a maximum deadweight loss attributable to changes in the merged company's product line of \$3 million, the maximum total adverse effects of the merger are approximately

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\$8.6 million, which the Tribunal notes is far less than the proven efficiency gains of \$29.2 million. While the Tribunal also notes that there is no statutory basis under the Act for assuming an equal weighting of these effects, it concludes that, under any reasonable weighting scheme, the efficiency gains brought about by the merger will be greater than and will offset the merger's anticompetitive effects. As a result, for the second time, the order sought by the Commissioner is denied.

Commentary

It has been said that great cases like hard cases make bad law.²² So, too, do antitrust cases argued on the basis of unclear theories of economic harm and an incomplete evidentiary record. *Superior Propane* may be such a case.

Prior to 1998, the Competition Bureau supported a total surplus approach to section 96. However, the proposed merger of Superior and ICG presented the Commissioner with a dilemma. While the \$40 million income/wealth transfer expected to result from a price increase following the merger was significant, the \$3 million deadweight loss associated with the price increase was far less than the parties' claimed efficiency gains of \$29 million per year. As a result, in this case, a total surplus approach to section 96 necessarily would result in the merger being allowed (despite the fact that it would confer on the merged entity a very high share, and in many cases a 100% share, in many local markets - which the Commissioner stated publicly he could not condone).²³

Or would it?

As the Tribunal notes in the Decision, while the deadweight loss associated with a price increase of a specified magnitude is typically quite small in relative terms, this observation assumes that competitive conditions prevail before the merger. Where competitive conditions do not prevail before the merger, the deadweight loss from an anticompetitive merger can be much larger.²⁴

The Tribunal also notes that, in final argument in the first hearing before it, the Commissioner discussed this possibility at length and presented alternate estimates of the deadweight loss that would result from the merger. The Tribunal states that "[i]f these estimates had been properly introduced and had withstood cross-examination, the Tribunal might have concluded, using the Total Surplus Standard...that the estimated efficiency gains...did not exceed and offset the effects of lessening of competition so measured... It therefore cannot be said that the Total Surplus Standard necessarily would have led the Tribunal to approve the instant merger had the deadweight loss been measured properly."²⁵

It is not clear why the Commissioner did not advance this argument earlier in the proceedings. Perhaps it is because conceding the existence of market power pre-merger could have made it more difficult to establish a substantial lessening of competition under section 92. Whatever the reason, the argument was not advanced and, applying the total surplus standard based on the evidence before it, the Tribunal concluded that the section 96 test had been met.

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With the benefit of hindsight, the Commissioner's decision to appeal this matter (the first time) appears questionable. Rather than merely losing one (albeit an important) merger decision, and resolving to present well-reasoned, principled economic arguments supported by all necessary evidence the next time efficiencies are a determining factor in a merger case²⁶, the Commissioner took the position that the Tribunal's initial decision set a bad precedent that simply could not be allowed to stand.²⁷ The result? First, an Appeal Judgment with which many lawyers, economists and (it appears) the Tribunal disagree, which the Decision suggests was based on a less-than-complete understanding of the legislative history of the Act, section 96 and the differences between Canadian and U.S. merger law, which, in turn, compelled the Tribunal to state for the record and in rather unambiguous terms its view of Canadian competition law (which is quite unlike the view espoused by the Bureau), and which places upon the Commissioner an extremely heavy evidentiary burden in section 96 proceedings.²⁸ Second, a redetermination decision that not only goes against the Commissioner, but that has implications which extend far beyond the interpretation of section 96. The Decision also has implications for the interpretation of the Act in general and, in many respects, calls into question the very role of the Bureau and the Bureau's understanding of its enforcement mandate. In these circumstances, a further appeal was inevitable.

The particular outcome of this case aside, the appeal will be significant in at least two important respects. First, one way or another, the consumer/small business *versus* economic efficiency debate will be clarified, both in the context of section 96 and, likely, in the context of the Act in general. Of course, this will not be the end of the debate. The Commissioner's counsel recently stated that as long as the Commissioner has a right of appeal, he will use it.²⁹ Superior's counsel recently mused that perhaps the Commissioner [just] doesn't like section 96. He added, "If that's his point he should change the legislation".³⁰ It would indeed be unfortunate if the tortured history of *Superior Propane* were to provide the impetus for amendments to the Act that could undermine a relatively sound economic and legislative scheme.

Second, how the Court reacts to the Decision and the Tribunal's "clarification" of the Court's remarks in the Appeal Judgment will send an important message to the Tribunal regarding the extent to which the Court is prepared to defer to the Tribunal's expertise. To be sure, the Decision sends an equally strong message to the Court with respect to the Tribunal's view of its role in Canadian competition policy.

Notes

¹ Jay Holsten is Chair of the Antitrust and Competition Law Group at Torys LLP.

² [2002] C.C.T.D. No. 10 (the "Decision").

³ Competition Bureau, News Release, "Competition Bureau Review of Cinema Mergers Opens the Door to Competition" (22 April 2002).

⁴ Decision, at para. 186.

⁵ 2000 Comp. Trib. 16.

⁶ 2001 FCA 104, at para. 73 (the "Appeal Judgment").

⁷ The Court regarded this task as beyond its competence but within the competence of the Tribunal.

⁸ There were four principal reasons for the Court's rejection of the total surplus standard:

The statutory text – In the Court's view, the Tribunal's interpretation of the word "effects" in section 96 inappropriately narrowed it to a single effect, namely, the deadweight loss. The Court also attached "some weight" to subsection 96(3) of the Act, which limits the weight accorded to redistribution in assessing the efficiencies generated by a merger. The Court observed that no similar

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limitation is imposed by the Act on the effects side of the analysis, which suggests that, contrary to the Tribunal's conclusion, Parliament did not intend to impose such a limitation.

Predictability – The Court rejected the Tribunal's view that adopting the total surplus standard would make the results of a section 96 balancing exercise much more predictable.

Statutory purposes and objectives – In the Court's view, while section 96 gives primacy to the statutory objective of economic efficiency, the purpose clause of the Act (section 1.1) suggests that an interpretation of "effects" in section 96 should reflect each of the statutory objectives. In this regard, the Court noted that, when the Act was introduced in Parliament, "it was widely regarded as a consumer protection measure" and thus it seems unlikely that Parliament either intended or understood that the efficiency defence would allow an anticompetitive merger to proceed, regardless of how much the merged entity might raise prices, provided only that the efficiencies achieved by the merger exceeded the resulting loss of resources in the economy at large. The Court also noted that limiting anticompetitive effects to deadweight loss would permit mergers to proceed that result in the creation of a monopoly in one or more of the merged entity's markets. In the Court's view, that a merger could eliminate all consumer choice in certain markets, but that such removal of competition was not an effect that could legally be weighed under section 96, seemed at odds with the stated purpose of the Act, namely, "to maintain and encourage competition."

The authorities – The Court adopted Reid J.'s analysis of the legislative history of section 96 in *Hillsdown* [(1992), 41 C.P.R. (3d) 289] (the only prior Tribunal decision to consider the section) and agreed with Reid J.'s conclusion that the balancing requirement in section 96 should not be interpreted in substantially the same manner as the draft predecessors of section 96, which "explicitly permitted anticompetitive mergers when the resulting efficiency gains produced net savings of resources for the Canadian economy". The Court also noted that the U.S. *Horizontal Merger Guidelines* treat the exercise of market power leading to an increase in price above the competitive level as the most important anticompetitive effect of a merger, and the resulting wealth transfer from consumers to producers, as a misallocation of resources - although the Court acknowledged the limited relevance of the U.S. approach to the issue before it. In the Court's view, there was clearly more than one view as to whether competition policy should disregard *a priori* transfers of wealth and other effects of anticompetitive mergers.

⁹ The Tribunal was also clearly concerned that the Court "placed weight on the treatment of efficiencies under U.S. antitrust law and...used it as a benchmark to evaluate the Tribunal's assessment under the Act": Decision, at para. 115. In the Tribunal's view, the U.S. regime is primarily focused on consumer protection and is "hostile" to efficiencies, while the merger provisions of the Act are focused primarily on economic efficiency: Decision, at para. 159.

¹⁰ Decision, at para. 62.

¹¹ Decision, at para. 81.

¹² Bill C-42 (1976-77), Bill C-13 (1977), Bill C-29 (1983-84) and Bill C-91 (1984-85). Decision, at para. 49.

¹³ In the Tribunal's view, this conclusion is supported by the Appeal Judgment, wherein the Court states that "section 96 gives primacy to the statutory objective of economic efficiency": Appeal Judgment, at para. 90; Decision, at para. 82.

¹⁴ Decision, at para. 83.

¹⁵ In the Tribunal's view, "the Consumer Surplus Standard, which requires that the full amount of the transfer be added to the deadweight loss in establishing the effects of an anti-competitive merger, is so limiting that its adoption in all cases would be contrary to the conclusion of the Court, would rule out the inquiry that Professor Townley regards as necessary to assess the welfare effects of the merger, and generally makes the efficiency defence unavailable under the Act, and so cannot be correct in law because it vitiates the statutory provision in subsection 96(1). The fact that in this case proven efficiency gains of 7.5 percent of sales would not satisfy the Consumer Surplus Standard adequately demonstrates that the requirement therein is so high that it would be met, if ever, only in rare circumstances. Based on its review of the legislative history of the Act and the Parliamentary review of the 1986 amendments, the Tribunal concludes that the efficiency defence (and the exclusion of the limitations thereon in preceding bills) was not inserted into the Act for such limited use; rather, it was meant to be an essential part of the Canadian merger policy that emphasizes economic efficiency": Decision, at para. 215.

¹⁶ Under this approach, weights are assigned to consumer and producer losses and gains, based upon the composition of these two groups and other factors, in order to reflect societal attitudes toward equity among different income classes.

¹⁷ The anticompetitive effects (other than the redistributive effects) of the merger identified or discussed by the Tribunal in the Decision include the resource misallocation effect (i.e., the loss of efficiency) represented by the deadweight loss of \$3 million attributable to the merger, a further resource misallocation effect that could result from interdependent pricing in certain markets, the misallocation of resources that could result from the prospective elimination of programs and services by the merged firm, the prevention of competition in Atlantic Canada (which the Tribunal determined would result from the merger), an additional loss of efficiency and redistribution of

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income in interrelated markets, the loss of certain dynamic efficiencies, the fact that the merger would result in the creation of "monopolies" in a number of geographic markets, and the impact of the merger on small and medium-sized businesses.

¹⁸ The Tribunal is of the view that the Court did not direct it to consider the entire amount of the transfer as an anticompetitive effect attributable to the merger under section 96 - had the Court been of this view, it would no doubt have said so in clear terms: Decision, at para. 369.

¹⁹ Decision, at paras. 326, 327.

²⁰ Decision, at para. 367.

²¹ However, the Tribunal concludes that the weight is not determinable given the evidence on the record: Decision, at para. 367.

²² *Northern Securities Co. v. United States*, 193 US 197, 400 (1904), per Holmes, J.

²³ "First, the overriding purpose of the Act is to maintain a competitive system. It is not the role of the Bureau to sanction monopolies. Second, in our view, no merger to monopoly could ever, by definition, bring about gains in efficiency that offset the effects of the merger on competition": Konrad von Finckenstein, Q.C. (Address to the Canadian Bar Association, Competition Law Section Annual Meeting, Ottawa, 30 September 1999).

²⁴ Decision, at para. 165.

²⁵ Decision, at paras. 168, 169.

²⁶ As Howard Wetston, the former Director of Investigation and Research, stated following the *Hillsdown* decision: "[I]t should be understood that...the number of cases falling into this category will not be large" (Remarks to the Canadian Institute, Toronto, 8 June 1992).

²⁷ "We believe that the purpose of the *Competition Law* is to encourage competition in Canada," said Konrad von Finckenstein, Commissioner of Competition. "The impact of this decision is too important for competition for us not to appeal. If this decision is allowed to stand, it will be next to impossible to prevent the formation of monopolies in industries dominated by two firms" Competition Bureau, News Release, "Competition Bureau Appeals Decision in Superior Propane Case" (6 September 2000).

²⁸ In the Appeal Judgment, the Court stated at para. 157: "The Commissioner has the legal burden of proving the extent of the relevant effects...". As the Tribunal notes in the Decision, at para. 372, "demonstrating significant adverse redistributive effects in merger review will, in most instances, not be an easy task. This may be why the Commissioner has argued so strongly for the inclusion of the transfer in its entirety, no questions asked".

²⁹ I. Jack, "Obsession or Principle?" *Financial Post* (1 May 2002) FP 10.

³⁰ *Ibid.*
