



# Efficiencies in Merger Review



## Bulletin on Efficiencies in Merger Review

**March 2, 2009**

Final version



## **I. PURPOSE AND SCOPE**

Revisions to the Merger Enforcement Guidelines (“MEGs”) issued by the Competition Bureau (the “Bureau”) in 2004 included a new section on the efficiencies exception pursuant to section 96 of the *Competition Act* (the “Act”). That section of the MEGs describes the analytical framework that, in general terms, the Bureau applies when assessing the efficiency claims by merging parties (the “parties”) to determine if the efficiency gains that are likely to be brought about by a merger will be greater than and will offset the anti-competitive effects arising from that merger.

The purpose of this Bulletin is to provide, as a supplement to the MEGs, practical guidance to assist parties in understanding the Bureau’s enforcement approach in this area. This includes a description of the information that would be useful to the Bureau in its analysis of efficiency claims in general, and a clarification of the Bureau’s approach to concepts such as dynamic efficiencies and gains in efficiency that are likely to be generated outside of Canada.

It should be noted that the Bureau’s approach is to expeditiously identify those few transactions that may raise material competition concerns and provide quick clearance for remaining transactions to provide commercial certainty and allow parties to achieve any efficiencies as quickly as possible. Consistent with that approach, a thorough assessment of efficiency claims is unnecessary in the vast majority of the Bureau’s merger reviews. Nonetheless, where efficiencies may be material, as described in greater detail below, the Bureau encourages parties who choose to submit efficiency claims to do so at the earliest possible stage. In addition to allowing the Bureau to properly consider such efficiency claims, submissions regarding anticipated efficiency gains may also assist the Bureau in understanding the rationale underlying the proposed transaction.

## **II. PRACTICAL GUIDANCE ON THE SECTION 96 EFFICIENCIES EXCEPTION**

### ***Type of Information that is Useful to the Bureau***

Parties are encouraged to provide detailed information about gains in efficiency arising from their merger as early as possible in the merger review process. This assists the Bureau in providing a timely response as to whether a remedy is required in respect of the merger. Having detailed information regarding efficiency claims at an early stage of the process will facilitate the preparation of focussed follow-up information requests and/or the targeted use of other information-gathering mechanisms and, subject to confidentiality restrictions, enable the Bureau to test the claims during its market contacts regarding the merger.

The parties should provide detailed and comprehensive information that substantiates their alleged efficiency gains as well as information relating to deductions from gains in

efficiency such as the costs associated with implementing the merger. Typically, the Bureau uses industry experts to assist in its evaluation of efficiency claims. To properly assess efficiency claims, Bureau officers and economists, as well as experts retained by the Bureau, require access to detailed financial and other information.<sup>1</sup> The Bureau may also require physical access to certain facilities and will likely require documents and information from operations-level personnel who can address, among other matters, how their business is currently run and areas where efficiencies would likely be realized.

### ***Burden on the Parties***

Under a section 96 analysis, the parties have the burden of establishing the elements stated below regarding the gains in efficiency and the Commissioner has the burden of establishing the anti-competitive effects of the merger. The parties' burden includes proving that the gains in efficiency:

- are likely to occur. In other words, the parties must provide a detailed explanation of how the merger or proposed merger would allow the merged entity to achieve the gains in efficiency. In doing so, the parties must specify the steps they anticipate taking to achieve the gains in efficiency, the risks involved in achieving these gains and the time and costs required to achieve them.
- are brought about by the merger or proposed merger, i.e., that they are merger-specific. While there is no requirement that the gains in efficiency arise uniquely from the merger, there is a requirement in section 96(1) that they be brought about by the merger. The test related to this aspect is whether the efficiency gains would likely be realized in the absence of the merger.<sup>2</sup> Thus, if certain gains in efficiency would likely be achieved absent the merger, those gains are not counted for the purposes of the trade-off.
- are greater than and offset the anti-competitive effects. The parties must provide a quantification of the gains in efficiency and a detailed robust explanation of how the quantification was calculated. They should also, to the extent relevant, provide an estimate of the significance of efficiencies related to optimal new product introductions or quality improvements. Gains in efficiency that relate to cost savings should also be broken down according to whether they are one-time savings or a recurring savings, and whether these savings result from fixed or variable (marginal) costs. While the burden is ultimately on the parties to establish that the gains in efficiency are greater than and offset

---

<sup>1</sup>This includes all pre-existing merger planning documents. Additional information that may be relevant includes (i) information on efficiencies realized from previous mergers involving similar assets; (ii) pre-merger documents relating to product and process innovation; and (iii) information related to economies of scale, including minimum efficient scale, and economies of scope in production.

<sup>2</sup>*Canada (Commissioner of Competition) v. Superior Propane Inc.* (August 30, 2000), CT-1998/002 (Competition Tribunal) (hereinafter "*Superior Propane*"), at ¶ 462.

the anti-competitive effects, in appropriate cases the Bureau will undertake its own internal assessment of the trade-off before deciding whether to challenge a merger at the Tribunal.

- would not likely be attained if an order under section 92 were made.<sup>3</sup> In other words, gains in efficiency that would likely be achieved, even if an order prohibiting all or part of the merger is made, are not counted for the purposes of section 96. For example, if remedying a substantial lessening or prevention of competition requires divestitures only in certain markets, cost savings resulting from the rationalization of head office facilities will not generally be included in the trade-off (as such savings would generally be achievable even if the divestiture of certain assets is required). A portion of head office cost savings may be relevant in this example only if the parties can clearly demonstrate that those cost savings would not be achievable if the proposed remedy is granted. Only those gains in efficiency that will be forgone as a result of the remedy will be counted.

### **III. FRAMEWORK CONSIDERATION**

On the issue of where cost savings likely to result from efficiency gains should be taken into account in Canadian merger investigations, the Bureau's current enforcement policy follows the direction given by the Competition Tribunal in the redetermination decision in *Superior Propane*. In that case, the Tribunal stated that Parliament intended that "efficiencies are to be considered only under section 96 and not under section 92". Consistent with this decision, the Bureau considers whether cost savings likely to result from substantiated efficiency gains offset the likely anti-competitive effects of a transaction under the efficiencies exception found in section 96 of the Act. By incorporating an explicit exception for efficiency gains, Parliament has indicated that the assessment of the competitive effects of the merger be segregated from the evaluation of efficiency gains.

This approach is consistent with the Canadian legislation which incorporates an explicit efficiencies exception, in contrast to the so-called integrated analysis applied in other jurisdictions (such as the United States and the European Union), where efficiency gains are considered as one of many factors in determining whether the transaction is likely to substantially lessen competition.

That said, cost savings from substantiated efficiency gains may be relevant to the analysis under section 92 of whether the merger is likely to substantially lessen or prevent competition in the following limited sense: the Bureau will consider whether, as a result of true cost savings, the

---

<sup>3</sup>This requirement is described in the MEGs at ¶s 8.7 and 8.17.

parties to the merger are better positioned to compete in a competitive market or are less likely to engage in coordinated behaviour.<sup>4</sup>

While a different approach to weighing efficiency gains against the anti-competitive effects may be appropriate in a specific case, the Bureau will generally follow the direction given by the Competition Tribunal in *Superior Propane* by applying the balancing weights standard when considering the trade-off analysis contained in section 96.<sup>5</sup> Under the balancing weights standard, any increase in surplus arising from the efficiency gain from the merger is balanced against the deadweight loss resulting from the likely anti-competitive effects of the merger and, where appropriate, some portion (including possibly all or none)<sup>6</sup> of the associated transfer of surplus from consumers to producers.<sup>7</sup>

Whether some portion of the transfer is included in the trade-off analysis depends on the value consumers place on the surplus relative to producers (i.e., the owners, including shareholders, of the merged entity). If consumers of the relevant product(s) are worse off than producers, a portion or all of the transfer is counted as part of the loss in surplus that would have to be offset by any efficiency gains that result from the merger. If consumers are as equally well-off as producers, the redistribution of income as a result of the merger would not be considered a loss in surplus under the standard, but as a neutral redistribution of income.

The Bureau anticipates that, in the vast majority of mergers, the difference between the anti-competitive effects and the gains in efficiency will be sufficiently large that it will not be necessary to determine whether a portion of the transfer is adverse under the balancing weights standard. For those mergers where it is necessary to determine whether a portion of the transfer is adverse, the redetermination decision in *Superior Propane* identifies a number of factors to be considered:

- the balancing weight relative to that implied by the general proportionality of effective tax rates;

---

<sup>4</sup>The impact of efficiencies on a firm's cost structure may render coordination more difficult by enhancing its incentive to act as a maverick.

<sup>5</sup>As noted in section II of this Bulletin, the burden is ultimately on the parties to undertake the entire trade-off analysis and persuade the Tribunal that the gains in efficiency are greater than and offset the anti-competitive effects. Nonetheless, the Bureau may choose to undertake its own internal assessment of the trade-off when deciding whether to challenge a problematic merger at the Tribunal in the absence of a settlement.

<sup>6</sup>If some portion of the transfer is considered an anti-competitive effect, that portion, following the language used in *Superior Propane*, is referred to as the adverse portion of the transfer.

<sup>7</sup>The Tribunal defines the "balancing weight" in *Superior Propane* as the weight accorded such that consumer loss and producer gain are just balanced. The Bureau considers this weight and, as part of this consideration, the portion of the transfer from consumers to producers that may be adverse.

- the income level of the consumers of the product at issue relative to relevant average incomes and relative to incomes of producers of the product;
- how the product at issue is used, and whether that use tends to be one engaged in by relatively higher income groups. For example, the Tribunal noted in the redetermination decision in *Superior Propane* that less weight would be placed on the redistribution effects among households that use propane for swimming pools, heating second homes and so forth; and
- where affected consumers are businesses, the relative profitability of those businesses and their ability to pass on price increases.

#### IV. DYNAMIC EFFICIENCIES

As noted in the MEGs, attaining dynamic efficiency is important to the international competitiveness of Canadian industries, and mergers may result in either a loss or gain in dynamic efficiencies. Accordingly, the proper assessment of a merger's impact on the optimal introduction or improvement of products and production processes is often a key factor in Bureau reviews in concentrated industries characterized by rapid technological change and innovation.<sup>8</sup>

Where possible, the assessment of dynamic efficiencies is conducted on a quantitative basis. This is generally the case if there is information presented by the parties to suggest that a decrease in production costs as a result of an innovation in production technology or an increase in demand for the parties' products as a result of product innovation (leading to a new or improved product) are likely. Absent quantitative information, a qualitative assessment is conducted.

The specific environment of the industry in question is important in the Bureau's analysis of the competitive effects of a merger on innovation. In light of the complexities and uncertainties associated with the assessment of dynamic efficiency claims, irrespective of the industry, certain types of industry information (in addition to that considered in section II above) can be particularly beneficial to the Bureau's assessment of a merger's impact on innovation as they relate to, for example, verifiability, likelihood of success and timeliness. Historical information on the effect of previous mergers in the industry on innovation may be particularly

---

<sup>8</sup> In light of the inherent difficulty in forecasting a merger's effect on dynamic efficiencies, which aggravates the already challenging predictive nature of merger investigations, the Bureau commissioned an independent third-party study to consider how best to assess the competitive impact of a merger on innovation and dynamic efficiency. The conceptual framework proposed in this independent report, entitled *Innovation and Dynamic Efficiencies in Merger Review*, provides a valuable contribution to the ongoing debate. Consistent with the MEGs, and indeed the defining principle of the independent report, the Bureau will continue to assess the impact of proposed mergers on dynamic efficiencies on a case-by-case basis.

insightful.<sup>9</sup> Such information may relate to a merger's impact on the nature and scope of R&D activities, innovation successes relating to new or existing products or production processes, and the enhancement of dynamic competition.<sup>10</sup> In addition, and only if applicable, the Bureau encourages parties to provide detailed explanations regarding plans to utilize substitute or complementary technologies so as to increase innovation.

## V. GAINS IN EFFICIENCY FROM NON-CANADIAN SOURCES

It is clear that the gains in efficiency that are relevant under the Act (like the anti-competitive effects) are those that accrue to the Canadian economy, whether such efficiency gains are productive or dynamic in nature. For example, productive efficiency gains arising from the rationalization of the parties' facilities located outside of Canada that do not benefit the Canadian economy<sup>11</sup> as cognizable efficiencies under the Act are not considered to be efficiency gains for the purpose of section 96.

The language of section 1.1 and section 96(2) provides some guidance on what consideration should be given to gains in efficiency that are likely to be achieved outside Canada. In the purpose clause of the Act, promoting "the efficiency and adaptability of the *Canadian economy*" is one of four goals of maintaining and encouraging competition *in Canada*. This appears to be a clear indication that achieving efficiencies that benefit the Canadian economy falls within the "purpose" of the Act. Notably, a merger involving one or more foreign-owned firms that will likely result in gains in productive efficiency from facilities located in Canada are relevant to the analysis. For productive efficiencies, in determining what should be counted as a "gain in efficiency" for the purpose of Section 96, the issue is whether the efficiency gains will benefit the Canadian economy rather than the ownership of the company.<sup>12</sup> Further, in conducting the trade-off analysis under section 96, the Bureau will consider whether substantiated efficiency gains benefiting the Canadian economy are greater than and offset the anti-competitive effects of a transaction in Canada.

---

<sup>9</sup> Such information is useful even if previous mergers did not necessarily involve any of the merging parties, as Bureau staff will, as appropriate, carefully examine the effect of past industry mergers on innovation through various sources of information, including industry experts and interviews with competitors.

<sup>10</sup> Dynamic competition refers to competition based on the successive introduction of new or better products over time.

<sup>11</sup> A rationalization of the parties' facilities located outside of Canada where it could be established that these efficiencies would likely result in lower prices in Canada is an example of how such gains in efficiency from non-Canadian sources could accrue to the Canadian economy.

<sup>12</sup> In contrast, the nationality of the ownership of the company is relevant to the analysis when evaluating the wealth transfer as part of the anti-competitive effects analysis (the other side of the equation in the trade-off).

## **VI. CONCLUSION**

The Bureau is mindful of the important role of efficiencies in enhancing competitive markets in Canada, and the significance of the inclusion of an efficiencies exception in the merger provisions of the Act. Accordingly, the Bureau will, in appropriate cases, make an assessment of whether the efficiency gains that are likely to be brought about by a merger will be greater than and will offset the anti-competitive effects arising from that merger and will not necessarily resort to the Tribunal for adjudication of the issue. However, the Bureau must be able to validate efficiency claims to ascertain the magnitude, likelihood and timeliness of the asserted gains, and the basis on which the claims are being made. Detailed information provided at an early stage of the review will assist the Bureau in providing a timely response on whether it will challenge a problematic merger at the Tribunal in the absence of a settlement.

Canada 

