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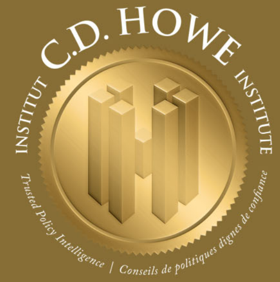

From: Peter Glossop

To: Canada's Competition Law Community

Date: February 17, 2022

Re: **Efficiency Defence: Let's Lose It**

The efficiency defence in section 96 of the *Competition Act* enables an anti-competitive merger to proceed if the efficiencies it generates are greater than and offset its anti-competitive effects.

The efficiency defence primarily promotes the benefit to the economy of cost savings accruing to the merging businesses and their shareholders over the detriment to the economy of higher prices that may be charged to customers by the merged firm.

Notably, there is no requirement for the merged firm to pass its cost savings to its customers to be eligible for the defence.

The Act allows the competition authorities to consider different factors (such as foreign competition, barriers to entry, change and innovation, etc.) in assessing whether a merger is anti-competitive. None of these factors (alone or in combination) can serve as a defence to an anti-competitive merger.

The efficiency defence sets up a unique exception to the rule that an anti-competitive transaction must either be blocked or modified to eliminate the competition problem.

However, the original purpose of this defence has largely disappeared. If Canada were to re-design the *Competition Act* today, it is very likely that there would be no efficiency defence. Although the defence was introduced into the Act in 1986, it was rooted in economic thinking dating back to the 1960s. In the 1960s, sub-scale "branch plants" were characteristic of the insular economy prevailing in Canada before the advent of the late-1980s free-trade agreement with the US.

"The efficiencies defence was created in recognition of the size of Canada's domestic market," noted the Supreme Court of Canada in the 2015 *Tervita* case. "And with an eye toward supporting operation at efficient levels of production and the realization of economies of scale, particularly with reference to international competition."

However, with the reduction of tariff and non-tariff barriers to international trade over successive rounds of trade liberalization, (and fewer obstacles to inbound acquisitions of Canadian firms by foreign firms) Canadian firms now have other tools besides merging among themselves to better achieve minimum efficient scale and to become more effective international competitors.

The original industrial policy purpose of the defence is reflected in the language of section 96(2) of the Act, which mandates a consideration of whether the efficiency gains will result in increased exports or substitution of domestic products for imported products.

Although section 96(2) has not played an important role in validating efficiencies, *Tervita* alluded to its relevance (in the context of a merger involving local waste disposal sites) by observing that "operational efficiencies obtained do not appear to have been central to the acquiring party's ability to realize economies of scale to compete in the relevant market" and accordingly "this case may not represent one that Parliament had in mind in creating the efficiencies defence."

In effect, Canada's efficiencies defence permits an anti-competitive merger whose strategic motivation is not fundamentally about achieving international competitiveness through efficiency. Indeed, the leading cases successfully relying upon the defence have involved domestic local markets.

The 2005 Report of the Advisory Panel on Efficiencies recommended the retention of an efficiency defence as a means of overcoming the productivity gap between Canadian and other OECD countries, and to deal with lingering efficiency challenges facing Canadian industry.

However, this recommendation seems to have assumed that merger review undertaken within the framework of the *Competition Act* should continue to implement industrial policy objectives, such as addressing a productivity gap and general efficiency challenges. Arguably, other more targeted tools– developed outside of a competition law framework and focused on specific industry issues – are a better means of achieving these objectives.

So, what should be done about the efficiency defence?

Efficiencies in transactions should be considered by including them as one of the statutory factors in merger review rather than as an absolute defence to an anti-competitive merger.

Under this flexible approach, significant efficiencies or those that are likely to be passed on to customers would still be considered in the Competition Bureau's overall analyses. However, efficiencies alone would not compel the Bureau to clear an anti-competitive merger. This approach also would better align Canada with other jurisdictions such as the US (which has no efficiency defence).

In short, the next package of amendments to the *Competition Act* should repeal the efficiency defence and replace it with a new statutory factor that considers the nature and extent of efficiencies in determining whether a transaction is anti-competitive.

Peter Glossop is a recently retired competition lawyer.

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