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INDUSTRY REGULATION AND COMPETITION POLICY

Promoting Innovation and Efficiency by Streamlining Competition Reviews

by
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- In an increasingly competitive global marketplace, Canadian economic efficiency and innovation should be the paramount objectives of merger review by the Competition Bureau.
- While strategic mergers between competitors can generate significant benefits to the economy, these mergers take the longest time and cost the most to be reviewed.
- A number of policy changes are recommended, including conferring additional resources on the Bureau, allowing expedited access to the Competition Tribunal to resolve disputes in merger matters and updating the Merger Enforcement Guidelines to reflect the importance of merger efficiencies.

Canadian merger-and-acquisition (M&A) activity was sharply higher in 2016, including the announcement of a large number of strategic mergers between competitors.[1] The opportunity to realize efficiencies and accelerate innovation is often a driving force behind strategic mergers between competitors. A merger between competitors may, for example, allow them to share technology or process improvements, co-ordinate logistics for delivery and enhance productivity or

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1 Strong Canadian M&A activity continued in the first half of 2016 with approximately "$122.8 billion worth of transactions involving Canadian firms were announced in the year through June 29, 2016, up almost 20 percent from the same period last year, according to data compiled by Bloomberg." See Scott Deveau, "Canada M&A Hits Brexit Roadblock After Roaring Start to 2016," *Bloomberg*. June 30, 2016.

pool resources.[2] Mergers and joint ventures are presumed to create efficiencies, which is why mergers are reviewed differently under the *Competition Act* than other potentially less efficient business conduct.[3]

The Supreme Court of Canada has recently provided new guidance on, and heightened the importance of, efficiencies in merger review, noting that they are to be given primacy in merger analysis under the *Competition Act*.[4] The Competition Bureau itself has held consultations on intellectual property and innovation in furtherance of its innovation-focused annual plan,[5] and recently approved a merger under Section 96 of the *Competition Act* on the basis that the efficiencies from the merger were very significant.[6] At the same time, the federal government has prioritized innovation as part of its agenda, emphasizing that "innovation is the path to inclusive growth."[7]

While these steps reflect the importance of merger efficiencies to the Canadian economy, there is still a subset of mergers – those that involve combinations of major competitors intended to achieve significant efficiencies – that can face delays under the *Competition Act*.[8] These are the kinds of mergers that take the longest time and

2 Hon. Navdeep Singh Bains, "Innovation should be a Canadian value," *Toronto Star*. May 2016. "Innovation is fundamental to our continued growth and job creation, and it's impossible to predict where and how disruption will happen. It can be in a start-up garage in Vancouver, a mine in Saskatoon, or a fishery in Saint John."

3 For example, agreements between competitors to fix prices or reduce output are strictly prohibited by Section 45 of the *Competition Act*, without consideration of efficiencies. However, because mergers and joint ventures usually involve the integration or sharing of assets or operations and are likely to generate efficiencies, they are only prohibited if they prevent or lessen competition substantially and do not generate overriding efficiencies.

4 *Tervita Corp v Canada*, 2015 SCC 3 at para 111: "Section 96 does give primacy to economic efficiency."

5 See Competition Bureau (2016) "2016–2017 Annual Plan: Strengthening Competition to Drive Innovation"; Competition Bureau (2015), "Competition Bureau seeks input on its updated *Intellectual Property Enforcement Guidelines*"; and Competition Bureau (2014), "Highlights: Competition Bureau's Innovation and Antitrust Workshop." (November, 2014.) Online: <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03864.html>.

6 Competition Bureau, "Statement regarding Superior's proposed acquisition of Canexus" June 2016: "After assessing the efficiency gains that were likely to be brought about by the merger, the Bureau issued a No Action Letter confirming that it will not challenge the proposed transaction before the Competition Tribunal under the merger provisions of the act." Other position statements issued by the Bureau have referenced efficiencies, but the Bureau did not rely on the conclusion that the efficiencies from the transaction were likely to outweigh the predicted anti-competitive effects when making its decision. See, e.g., Competition Bureau statement regarding the proposed acquisition by Postmedia Network Inc. of the English-language newspapers of Quebecor Media Inc. March 25, 2015., Online: <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03899.html> ("In coming to its decision to issue a No Action Letter, the Bureau also weighed substantive efficiencies submissions by Postmedia suggesting that the proposed transaction is likely to bring about meaningful cognizable efficiencies.")

7 See Innovation, Science and Economic Development Canada (ISED) (2016), "Positioning Canada to Lead: An Inclusive Innovation Agenda"; Canada, "Budget 2016" in Sessional Papers, No. 8570-421-2 (2016) at 111 and following; Rt. Hon. Justin Trudeau, "Minister of Innovation, Science and Economic Development Mandate Letter" (November, 2015.) Online: Office of the Prime Minister <http://pm.gc.ca/eng/minister-innovation-science-and-economic-development-mandate-letter>; Rt. Hon. Justin Trudeau, "The Canadian Opportunity: Address by the Right Honourable Justin Trudeau, Prime Minister of Canada at the World Economic Forum in Davos, Switzerland." (January, 2016). Online: Liberal Party of Canada <https://www.liberal.ca/the-canadian-opportunity/>.

8 We acknowledge that the Bureau clears the vast majority of non-complex mergers quickly.

cost the most to be reviewed. Strategic mergers between competitors can generate significant efficiencies to the economy, in part because they can allow firms to achieve cost synergies, operate at scale, offer new products and invest profits in the development of new product innovations or technologies. It is that subset of mergers that are the subject of this paper.

We recognize, too, that complex merger reviews take time to complete. However, the review of strategic mergers imposes the greatest burden on merging companies in terms of time, document production and legal costs notwithstanding the important implications of such mergers for the economy.[9] We also recognize that the Bureau lacks the resources to deal with these kinds of mergers as quickly as it would like.[10]

These obstacles function like regulatory "taxes" on firms that are considering or trying to undertake strategic mergers. These taxes may discourage Canadian businesses from proposing and pursuing a socially optimal level of such mergers. Accordingly, the time is right to ask whether changes are needed to the Bureau's merger review process to ensure that Canada is actively promoting efficiencies and innovation when the Bureau is reviewing strategic mergers. We propose four changes to address this issue:

1) Confirm that the predominate purpose of merger review is to increase the efficiency of the Canadian economy, including by revising the Merger Enforcement Guidelines to reflect the pro-efficiency state of the law as articulated by the Supreme Court;
2) Ensure timeframes set out in the *Competition Act*, and in the Bureau's Merger Review Process Guidelines are adhered to, and that the Bureau has adequate staff and financial resources to expedite the review of strategic mergers intended to generate significant efficiencies for the Canadian economy;
3) Grant merging parties expedited access to mediation or to the Competition Tribunal (a specialized and experienced court that adjudicates disputes principally between the Bureau and businesses) to adjudicate or mediate merger cases; and
4) Use the existing provisions of the *Competition Act* to prevent decisions of foreign agencies, or other Canadian federal or provincial boards or tribunals, from interfering with the realization of efficiencies and increased export opportunities from Canada that mergers may present.

As businesses operating in Canada continue to face pressure to become more competitive globally, Canada's merger review regime should promote mergers likely to increase economic efficiency and accelerate innovation in Canada. In this paper, we discuss the policy changes that the federal government or Bureau can implement to achieve their objectives.

9 See Peter Boberg and Andrew Dick (2014) at 26-37, finding that on a per-month basis, the median compliance cost with a second request in the United States was approximately US$1 million. The median investigation length was 5.9 months from the issuance of the second request until the investigation was closed or the reviewing agency took action.

10 The Bureau's annual budget is approximately $49 million and as of the Bureau's 2015 year end, it employed 368 full-time employees, only a portion of which are dedicated to merger review. See Competition Bureau, "Annual Report of the Commissioner of Competition for the Year Ending March 31, 2015." Spending has actually decreased since 2011 even though the value of Canadian deals in 2015 totalled approximately C$374.1 billion, reflecting a 51 percent increase over 2014 on an annualized basis. See note 1 *supra*.

Background

There are three types of efficiencies that can arise from a strategic merger between competitors: productive cost savings, allocative efficiencies (demand expansion) and innovation.[11] All three types have been the focus of recent developments. Mergers can increase productivity by improving how companies use their facilities, logistics, technology and labour. As a result, mergers can:

- reduce fixed and variable costs to make Canadian companies more cost-competitive internationally, leading to greater exports;[12]
- allow efficiencies to diffuse within an industry causing other firms to reduce costs and accelerate their own innovations;[13]
- increase allocative efficiency by, for example, generating demand expansion, such as when networks merge allowing for a more valuable overall product offered at lower cost; and
- enhance the pace of innovation through the sharing of knowledge, intellectual property and best practices.[14]

As the Commissioner of Competition has recently stated, "for consumers, innovation brings more choices and higher quality products and services in a dynamic marketplace."[15] Innovation drives economic growth and strengthens the economy as a whole. The Organisation for Economic Co-operation and Development has explained that innovation can also help to address "pressing social and global challenges at the lowest cost," making economies "more productive, more resilient, more adaptable to change and better able to support higher living standards."[16]

Lawmakers in Canada have long believed this to be true. When it enacted the *Competition Act* in 1986, Parliament recognized that firms operating in Canada need to be able to exploit scale economies to remain competitive internationally. It included a provision to encourage strategic mergers and prevent mergers from being blocked based solely on market shares. When Parliament amended the *Competition Act* again in 2009, it not only maintained the efficiencies provision but created a parallel provision applicable to joint ventures and other competitor collaborations.[17] Indeed, in the postscript to the Supreme Court's decision in the Tervita case, Justice Rothstein affirmed that the "efficiencies defence was created in recognition of the size of Canada's

11 See Brodley (1987).

12 See note 6 *supra* regarding the Bureau's approval of Superior Plus / Canexus.

13 Roberts and Salop (1996).

14 See Schilling (2015).

15 John Pecman, Commissioner of Competition, "*Competition, Innovation and Infrastructure*: Remarks by John Pecman, Commissioner of Competition" (May 2016). Online: <http://competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/04092.html>.

16 OECD (2015). *Innovation Strategy for 2015: An Agenda for Policy Action*, at 3-4.

17 *Bill C-10, An Act to implement certain provisions of the budget tabled in Parliament on January 27, 2009 and related fiscal measures*, 2nd Sess, 40th Parl, 2009, pt. 12 (assented to 12 March 2009), SC 2009, c 2.

domestic market 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."[18]

The ability to compete with scale and earn profits allows companies to make investments in new technologies or processes, which otherwise might not be made when companies are struggling to earn a profit. As Peter Howitt noted in a recent paper, there are points at which increasing competition can actually have the effect of reducing overall innovation.[19] As Gary Roberts and Professor Steven Salop have observed, "Mergers can also lead to diffusion of cost savings over time through the broader process of inducing competitive innovation."[20] Rivals that feel threatened by a merged firm will have extra incentives to innovate by taking steps to reduce costs and improve their own products.

Yet only one reported merger has ever been approved by the Bureau decidedly on efficiencies grounds. That approval came in 2016 after a nine-month review.[21]

Reforming the Merger Review Process

Culture Shift to Prioritize Efficiencies

Despite the priority given to efficiencies under the *Competition Act*, the current merger review process views efficiencies and innovation as an afterthought; i.e.,[22] it focuses first and foremost on attempting to identify whether a transaction is anti-competitive.[23]

In a recent speech, the commissioner reiterated his view that the efficiencies defence is "bad for business and bad for consumers."[24] We do not accept this to be the case, and neither did Parliament when it enacted the efficiencies provisions. Even though some other notably larger jurisdictions may not have efficiencies provisions in their competition laws, the implementation of these provisions in Canada was intended to make Canadian

18 *Tervita Corp v Canada*, 2015 SCC 3, at para. 167.

19 See Howitt (2015). Aghion et al. (2005) show that this inverted-U relationship between innovation and competition does indeed exist in UK manufacturing sectors, while Bérubé et al. (2012) find similar results using Canadian data.

20 Robert and Salop, *supra* note 13.

21 The Canadian economy never had the opportunity to realize the efficiency benefits, though, as the transaction was challenged by the U.S. Federal Trade Commission and was later abandoned by the parties. Superior Plus, "Superior Plus Announces the Termination of the Arrangement Agreement with Canexus" (June 2016). Online: <http://www.superiorplus.com/News.php?id=2074395>.

22 See Paul S. Crampton (1993), "The Efficiency Exception for Mergers: An Assessment of Early Signals from the Competition Tribunal." "Given that ss. 96 (mergers) and 86 (specialization agreements) embody a more explicit emphasis on efficiency gains than any other provision in the Act, it is reasonable to infer that Parliament intended these provisions to be very important tools for facilitating the pursuit of the efficiency objective highlighted in s.1.1 of the Act."

23 Competition Bureau (2011). "Merger Enforcement Guidelines," at pt 12.

24 Commissioner of Competition (2016), "Strengthening Competition: Innovation, Collaboration and Transparency."

businesses more effective competitors domestically and internationally by allowing them to achieve economies of scale and reduce costs.

For mergers that are likely to generate significant efficiencies for the Canadian economy, the merger review process should focus on validating those efficiencies as quickly as possible.[25] We acknowledge that the merging parties are the main source of information about the merger efficiencies and the parties should raise efficiencies considerations early and often. That said, the initial stages of a Bureau review should also focus on gathering information about the efficiencies and the Bureau should be open to engaging with the parties on efficiencies claims.

Part of the reluctance of merging parties to engage early on efficiencies may be attributable to the standard that the Bureau applies when assessing efficiencies claims. These manifest in two parts of the Bureau's Merger Enforcement Guidelines that address efficiencies.

First, by requiring that the efficiencies "more than marginally exceed" or "significantly outweigh" the likely anti-competitive effects, parties may be less willing to engage early on because they want to wait until the Bureau has set the benchmark for the likely anti-competitive effects.[26] The Supreme Court has ruled, however, that efficiencies that numerically exceed the anti-competitive effects, even if only marginally, are sufficient to justify a merger.[27] Section 12.33 of the Merger Enforcement Guidelines should be revised to reflect the case law to confirm that the Bureau will not challenge mergers where it finds that the efficiencies gains exceed the likely anti-competitive effects, even by a small degree. This would signal to the business community that efficiencies and innovation matter and that the Bureau will not litigate cases where it concludes that the efficiencies trade-off has been satisfied.

The second issue relates to the position in the guidelines on whether the Bureau should count efficiencies that would not likely be attained if the Tribunal were to make an order remedying all or part of the merger. The Bureau bases this position on its interpretation of the second clause of Section 96(1), which states that "The Tribunal shall not make an order under Section 92 if it finds that … the gains in efficiency would not likely be attained if the order were made." The Bureau takes the position that in applying the second clause of subsection 96(1), it must weigh the efficiencies lost as a result of a Tribunal order against the anti-competitive effects remedied by the order and thus it can still make orders that reduce merger efficiencies provided that order also remedies anti-competitive effects.[28] Not only is such an approach inconsistent with the plain language of Section 96, it has two major downsides: It creates uncertainty for merger planning because parties cannot predict how their merger will be theoretically restructured, and any process that allows for divestitures or other remedies

25 See Schilling 2015, *supra* note 14 at 192: "There is widespread consensus that the goal of antitrust laws are [sic] to promote economic welfare. Given the contribution of innovation to economic welfare, it should be clear that antitrust laws must pursue *dynamic efficiency*, that is, an appropriate balance between short-run static efficiencies such as reducing costs and maximizing consumer surplus (*productive efficiency and allocative efficiency*) with longer-term efficiencies that arise from innovation."

26 See note 24 *supra*. See also Merger Enforcement Guidelines, *supra* note 23 at s. 12.33.

27 *Tervita, supra* note 4 at para 151: "where proven quantitative efficiency gains exceed the proven quantitative anti-competitive effects to only a small degree, the tribunal may still find that the s. 96 defence applies."

28 See Merger Enforcement Guidelines, *supra* note 23 at s. 12.13.

necessarily means that all merger efficiencies will not be attained.[29] Instead, the Bureau should not seek (and the Tribunal should not issue) orders that reduce total merger efficiencies.

Abide by the Statutory Timelines

The lack of a definitive timeline within which the Bureau must complete its review creates uncertainty for businesses and delays closing and the realization of merger efficiencies. In 2009, Parliament adopted a US-style merger review framework and extended the prior statutory review period beyond the 42-day period in place at that time.[30] Although the current statutory review framework contains two fixed 30-day periods, merging parties face timing uncertainty at two other points in the process: compliance with a Supplementary Information Request (SIR); and following the expiry of the second waiting period in anticipation of a clearance or challenge decision by the Bureau.

The scope of an SIR issued in a particular review is often a major source of delay in the process. Once the Bureau issues the SIR, the waiting period is suspended. SIRs typically contain questions that require the production of considerable irrelevant information. SIRs can impose delays of two to six months, cost millions of dollars in legal and e-discovery fees, and result in the review of millions and the production of hundreds of thousands of electronic records.[31] Unlike other types of production orders that have guarantees of judicial oversight, the merging parties do not have recourse to an impartial judge to review the scope of the SIR.

Once the merging parties comply with the SIR, a second 30-day waiting period commences, after which time the parties are no longer prohibited from closing unless the Tribunal issues an order preventing closing. This means that a typical review period for a merger where a SIR has been issued ranges from four to eight months, and can be longer.[32] Indeed, merging parties often wait for the Bureau to issue a "No Action" letter indicating that it will not challenge the merger before the Tribunal. In practice, the Bureau's merger review can continue well past the end of the waiting period under the *Competition Act*, particularly where the Bureau is waiting to issue a decision until competition agencies in other jurisdictions have completed their reviews. The Bureau requests that parties grant "waivers" in multi-jurisdictional mergers to allow other competition agencies to communicate with the Bureau. This often has the effect of compounding delay, as the Bureau will hold off on finalizing its analysis until other agencies, principally the US agencies, complete their reviews. Accordingly, businesses involved in cross-border strategic mergers often wait longer than eight months before the Bureau will finish its review of the merger.

Adherence to the second 30-day waiting period to make a decision would provide added timing certainty to the merging parties. Moreover, closing should not be prohibited unless the Bureau can establish that the Tribunal will be unable to remedy the merger should the Bureau proceed to litigation.

29 See Joshua A. Krane et al. (2016), at 463.

30 Bill C-10, supra note 17. See also Brian Facey (2009) "Canada should learn from U.S. experience before adopting new antitrust laws." *The Globe and Mail* (February 10).

31 Brian A. Facey and Cassandra Brown (2017) at 87-95; Facey, *ibid*.

32 The compliance period for the Supplementary Information Request plus the two 30-day periods. Based on an analysis of public information available on the Competition Bureau's Merger Register, public statements and securities filings.

We are not suggesting that efficiency-enhancing strategic mergers receive clearance on an accelerated timeline. Rather, the efficiencies analysis should proceed in tandem with the review of the likely merger effects and, where the merger efficiencies are significant, the Bureau should not hold up an approval.

Increased Role for the Competition Tribunal

The contrast between the Bureau's treatment of efficiencies and the pronouncements of the Tribunal, the courts, and government leaders reinforces why a separation of powers between enforcement agencies and decision makers is critical to the merger review process.[33] The institutional framework is already in place as the Tribunal has the specialized expertise to render decisions quickly on merger matters. Indeed, the Tribunal recently issued a guidance document called a "Practice Direction" on mediation in which it has invited parties to a litigated dispute to address issues informally and expeditiously before an impartial mediator.[34] It would be helpful if this procedure was available prior to or without litigation in the first place. There is no reason why mediation cannot play a more active role before a merger goes to litigation.

Parties should also have the ability to refer questions about the scope of a SIR to the Tribunal without requiring the commissioner's consent. Tribunal members already have a role (sitting as judges) in reviewing applications under Section 11 of the *Competition Act* for formal subpoenas for documents, data or oral examinations. Similarly discrete questions, such as market definition, barriers to entry and even efficiencies, could also benefit from this kind of simplified procedure, before the Tribunal or other impartial mediator.

Removing Obstacles to Co-operation

The Bureau has made extensive efforts at enhancing co-operation, both with domestic regulatory bodies and foreign competition law agencies in merger review.[35] Collaboration and alignment between competition agencies is laudable, where it can achieve efficiency and consistency in the review process. That said, each competition agency should apply its own governing laws. Accordingly, the Bureau should defend efficiency-enhancing strategic mergers that are put at risk by other competition law authorities or other provincial or federal boards or tribunals that have jurisdiction to review mergers.[36]

Parliament conferred the commissioner the authority under Section 82 of the *Competition Act* to apply to the Tribunal barring the enforcement of a foreign order where the foreign order would "adversely affect the

33 See Neil Finkelstein, Brian A. Facey and Jonathan Finkelstein (2009).

34 Competition Tribunal, "Practice Direction Regarding Mediation." (June 2016.) Online: <http://www.ct-tc.gc.ca/Procedures/Files/PDFs/eng/Practice_Direction_Mediation-eng.pdf>.

35 In total, the Bureau has entered into memoranda of understanding with 13 foreign agencies. See Competition Bureau, "International Efforts – Topics", online: <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/h_00128.html>.

36 The Canadian regime reflects the characteristics of the Canadian economy (i.e., an open economy with population centres scattered across a large, geographic area), but it has not been accepted by other jurisdictions, including the United States. The U.S. regime places greater emphasis on the competitive process and on consumer pricing in the consideration of efficiencies, unlike Canada. See *FTC et al v Penn State Hershey Medical Centre et al*, No. 16-2365 (3d Cir. 2016) in which a U.S. appeals court found that, even if the efficiencies defence were available, the efficiencies from the merger did not clearly outweigh the anti-competitive effects. The Court of Appeals granted the FTC's request for a preliminary injunction.

efficiency of trade or industry in Canada without bringing about or increasing in Canada competition that would restore or improve that efficiency." Of note, the commissioner has never applied for an order under that section. If the commissioner were to obtain an order under Section 82, foreign courts that apply the principles of comity might abstain from interfering with the merger, when the merger involves two Canadian companies.[37]

Conclusion

We are not advocating that all strategic mergers that bring about significant efficiencies should be allowed. The *Competition Act* provides for a balancing of consumer interests and efficiency interests, but places paramountcy on efficiencies in the review of mergers. In our view, a culture shift is needed to recognize the importance of efficiencies in the merger review process and not hold up mergers that are likely to generate significant efficiencies for the Canadian economy. Given the economic uncertainty facing Canada and the need for firms operating in Canada to be more efficient and more competitive globally, it is timely to consider policy changes that encourage efficiency-enhancing strategic mergers in Canada.

37 See *In Re: Vitamin C Antitrust Litig.*, No. 13-4791 (2d Cir. 2016) in which a U.S. appeals court overturned a damages award obtained against Chinese vitamin manufacturers for price-fixing on the grounds that the defendants were subject to conflicting legal requirements and thus, under principles of comity, the district court should have refrained from exercising its jurisdiction over the matter.

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